



The Role Of Micro Insurance In Reducing The Rural-Urban Gap In The Indian Landscape

The central theme of the paper is the vital role of micro insurance as a mechanism for reducing the significant rural-urban development gap in India and fostering inclusive national growth

1st Author

Smt Soni Singh Agnihotri

Research Scholar

Govt J.Y. Chhattisgarh
College Raipur, India

2nd Author

Dr Shweta Tiwari

Vice Principal,

M.A.I.C College
Raipur, India

3rd Author

Dr Tapesh Chandra Gupta

Principal,

Govt J. Y. Chhattisgarh
College,
Raipur, India

Abstract: The persistent disparity in economic opportunity and social protection between rural and urban India poses a major obstacle to inclusive national growth. This paper examines the critical role of micro insurance—products with low premiums, flexible payments, and simple procedures designed for low-income individuals—as a vital tool for bridging this gap.

Micro insurance directly tackles the core vulnerabilities that sustain the rural-urban divide. For low-income populations, who are predominantly rural, it functions as a crucial financial safety net. By providing pay-outs for shocks such as illness, crop failure or livestock hazard, it prevents households from selling productive assets like land or livestock and reduces reliance on costly informal loans. This asset protection encourages investment in higher-yield activities and alleviates financial hardship by reducing Out-of-Pocket (OOP) expenditure, particularly in health. Furthermore, micro insurance fosters inclusive growth by promoting economic and psychological security and, when linked with microfinance, helps keep the poor out of the poverty trap.

Despite its potential, micro insurance penetration in the huge rural market remains "very low". Key barriers include:

Demand-Side Barriers: Low awareness, misconceptions, a lack of simple and affordable products, and eroded trust due to complicated claim settlement processes.

Supply-Side Barriers: The absence of reliable distribution channels, high transaction costs, and a lack of data for creating viable business models outside of large government schemes.

To maximize its impact, the paper recommends a shift to innovative, tailored approaches, including:

Product Innovation: Developing simple, multi-risk products and simplifying product guidelines.

Leveraging Community Models: Utilizing the member-owned Mutual Model and strengthening partnerships with trusted grassroots organizations like NGOs, SHGs, and MFIs.

Digital Platforms: Using mobile applications and innovative I.T. solutions to improve distribution, operations, and servicing, especially in remote areas.

Sustained Education: Increasing household awareness in local languages and incorporating insurance education into the school curriculum.

In conclusion, micro insurance is an indispensable tool for achieving financial resilience and greater social security, helping individuals transition from a state of latent vulnerability to one of stability. A successful, sustainable model requires a blend of regulatory simplification, technological innovation, and socially-rooted distribution to fully realize the vision of truly inclusive national development.

Key Words: Micro-Insurance, Financial Inclusion, Financial Resilience, Poverty Alleviation, Social Protection, Inclusive growth, Risk Mitigation, Micro finance Institution (MFI), Self Help group (SHG), IRDA Regulation, Digital Platform, Asset Protection, Mutual Model.

1. Introduction

The disparity in economic opportunity and access to social protection between rural and urban India is a critical challenge to the nation's inclusive growth. Micro insurance, defined as insurance specifically designed for low-income individuals and households with features like low premiums, flexible payments, and simple procedures, emerges as a vital tool to bridge this gap. The first Micro Insurance Regulations came in 2005 which was amended from time to time. IRDAI Micro Insurance Regulations 2015 was notified in July 2015 with an objective to develop the micro insurance market in India.

1.1 About Micro insurance

Micro Insurance is a low-ticket size insurance for low-income group and micro enterprises. Micro insurance can play an important role in taking insurance to the masses. Insurance protection for the masses and inclusive growth of society are vital for social and economic development of India. Insurance is an indicator of not only economic progress but also social development of a country. Insurance provides a very powerful risk management mechanism for industries, businesses and a social safety net for individuals. Insurance is extremely necessary for low income and marginalised sections of the society as these people are extremely vulnerable to consequences of sickness, accidents or mishaps and do not have sufficient resources to fall back upon. It is necessary for a country like India where majority of population belongs to rural set up in some or the other way to make sure that insurance reaches every individual to provide resilience to fight back in exigencies.

Low-income populations, predominantly residing in rural areas, face higher vulnerability to risks like illness, accidents, crop failure, and property loss compared to their wealthier counterparts. While traditional insurance is largely inaccessible due to high premiums and complex, urban-centric distribution models, micro insurance offers a crucial financial safety net. By mitigating the financial impact of shocks, it serves as a powerful risk management mechanism and a social safety net, which are vital for the social and economic development of India.

The segment targeted by micro insurance—individuals earning between USD 1.9 to USD 5 per day—constitutes a significant portion of India's population. With 66% of the population earning between USD 1.9 to USD 5.5 per day and 40% of rural households falling within the Rs 5000 to Rs 12000/- per month income bracket, micro insurance is essential for promoting resilience and fighting exigencies across the country.

1.1 Legislative and Developmental Foundation

The formal push for micro insurance began with the Government of India forming a 'Consultative Group on Micro Insurance' in December 2003. This led to the IRDAI notifying the Micro Insurance Regulations in November 2005 to develop the market and prescribe a framework for affordable products. A key innovation was the legal recognition of NGOs, MFIs, and SHGs as "micro-insurance agents," which holds the potential to significantly increase rural insurance penetration.

India has an estimated 39.14 crore i.e. 82.7% of the working population engaged in unorganised sector and more than 50 % of GDP of India comes from unorganised sector. According to the recent

agricultural census (2011) 85% of farmers fall in Small and Marginal category. More than 61 % of rural households are categorised as deprived (Socio Economic Caste Census, Insurable population in India. The insurance requirements of rural India are different from their urban counterparts and cannot be met by formal insurance policies. The rural poor requires insurance cover which is reasonable and affordable. It was with this objective that IRDAI came out with Social and Rural Sector Regulation 2002(revised in 2015 and Micro Insurance Regulation 2005 (revised in 2015). However, reach of Micro insurance has been limited despite these efforts done in last one and half decades by the regulator. Only 14% people are covered under insurance in rural India (PWC, 2017).

Insurance companies have probably treated micro insurance primarily either as CSR activity or to fulfil social and rural obligations mandated by IRDAI. The launch of Jan Suraksha Schemes and PMFBY scheme has further impacted growth of this segment. Since insurance companies are able to meet their obligatory business requirements through these schemes, micro insurance has lost focus and space in their portfolio of products. Micro insurance products are by and large missing from the product offerings of the insurance companies. Liberalisation of the insurance sector and the Govt. Schemes have created awareness, demand and new opportunities for micro insurance. However, market penetration of Micro Insurance is seen to be very low in India. However, outside of Govt's Social Security Schemes and the Govt. sponsored or initiated schemes like PMJJBY, P MSBY, PMSYM Yojana and PMJAY (Ayushman Bharat), coverage through Micro Insurance remains abysmally low in India. There is a huge rural market but the protection gap is equally huge.

The study attempts to examine role of micro insurance in reducing rural-urban gap and various issues and challenges faced by them and what needs to be done by the insurers, intermediaries, regulators, policymakers and other stakeholders to increase the penetration of micro insurance. The study is relied on secondary data.

2. Role of Micro Insurance in Bridging the Gap

Micro insurance directly addresses the core vulnerabilities that sustain the rural-urban divide, primarily by providing financial resilience and fostering inclusive growth.

2.1 Poverty Alleviation and Financial Resilience

Poverty is characterized by latent vulnerability. Shocks (e.g., health issues, crop failure) can force poor households to sell productive assets, pushing them into a cycle of lower income, lower productivity, and higher vulnerability. Micro insurance acts as a defence mechanism against social and financial exclusion.

Preventing Asset Disposal: By providing a pay-out for risks like illness or crop failure, micro insurance prevents the need to resort to costly informal loans or the distress sale of assets, such as livestock or land, which are the main sources of livelihood in rural areas.

Encouraging Investment: When livelihoods are protected, low-income groups are encouraged to invest their resources in higher-yield activities rather than low-yield, defensive measures (like drought-resistant subsistence crops), thereby raising overall investment and growth rates.

Reducing Out-of-Pocket Expenditure (OOP): Especially in health, micro life insurance can substantially reduce OOP expenditure, alleviating financial hardships and contributing directly to poverty reduction.

2.2 Fostering Inclusive Growth and Empowerment

The provision of financial security is an indicator of not only economic progress but also social development. Micro insurance promotes greater economic and psychological security.

Linkage with Microfinance: When combined with micro savings and micro credit, micro insurance becomes an integral component of financial inclusion, helping to keep the poor segment away from the poverty trap. Microfinance institutions (MFIs) are often the primary touchpoints for offering credit and protection in villages, reaching areas where conventional banks have failed.

Community Resilience: When entire communities, particularly those dependent on agriculture, are covered against collective shocks like natural disasters, economic downturns, or health crises, they become more resilient. For instance, index-based crop insurance can directly help farmers avoid indebtedness and reduce issues like farmer suicide by compensating for lost crops due to low rainfall.

Empowering Women: Many products specifically target women, recognizing their central role in family financial management. This enhances women's economic security and decision-making power within the household and community.

3. Challenges to Maximizing Impact in Rural India

Despite its critical role, the market penetration of micro insurance in India remains "very low" and coverage is "abysmally low" outside of government social security schemes. The protection gap in the huge rural market is immense.

Demand-Side Barriers (The Target Segment):

- **Low Awareness and Misconception:** Rural households often lack the basic understanding of insurance and its benefits.
- **Product Suitability and Trust:** There is a lack of simple, affordable products and a perception that the existing offerings do not provide value for money.
- **Service Delivery:** Complicated claim settlement processes and poor grievance redressal erode trust and result in high lapsation rates. Only 2% of rural women who experienced income shocks utilized their insurance coverage due to gaps in awareness and claims processing.
- **Low-income market-** This group is looking for immediate and tangible returns for the investments they are making. Insurance products are generally designed in a manner that they fail to create value proposition for the buyers in the short term.
- **Perception about Value for Money-Low-income /rural market** is looking for immediate and tangible return for the investment they are making. Insurance products are designed in such a manner that they fail to create value proposition for the buyers in the short term. They find it difficult to comprehend how insurance products can deliver value for money, even if there is no guaranteed pay out. They do not understand concept of risk management and are not interested to take insurance as they feel they did not get any value in case of no claim.
- **Lack of Long-Term Planning:** Low-income households have short term focus and inclination towards short term financial decisions because of constantly changing and unpredictable circumstances and job insecurity.
- **Complicated Claim Settlement Process:** The only time insurance makes sense to masses is the time of claim settlement. That is the moment of truth. A common person feels lost at the time of claim filing because of lack of awareness about claim process. Complying with documentation/ requirements makes it further difficult and time consuming for the insured/ nominee/ legal heirs.

Supply-Side Barriers (Insurers and Intermediaries):

- **Distribution:** There is a lack of reliable distribution channels and high transaction costs associated with low-ticket size products.
- **Intermediary Capacity:** Intermediaries lack the necessary knowledge, skill, and professionalism, and are discouraged by low incentives.
- **Data and Viability:** Insurers lack data pertaining to the low-ticket size market, making it difficult to achieve a viable and sustainable business model outside of large government schemes.
- **High cost of delivery:** It makes micro insurance unviable for insurers. The market is yet to develop a delivery model where transaction cost is low.
- **Product Innovation:** Some of the insurance companies find that restrictions under the Micro Insurance Regulations hinder product innovation. For micro insurance, it can be said that the low-income market requires better quality products including quick claim settlements and few if any, claim rejections.
- **High Claim Ratio:** Some insurers opine that the premium under micro insurance is too low and not commensurate with claim amount. They use social insurance as a proxy to explain this. One of the insurers mentioned during the discussion that in PMSBY one death claim results in wiping out premium of 16,667 policies and in case of PMJJBY, one claim is equivalent to premium collected from 6000 policies. Though the figures may look a bit exaggerated the point was made clear.
- **High occurrence of frauds:** There is a general perception among insurers that number of fraudulent cases are high in Microinsurance. Especially, cattle insurance is perceived to be a loss-making portfolio by most of the companies because of high cases of fraud. One of the reasons cited is that claim investigation is not conducted for such policies. It is difficult to find cost effective mechanism to reduce these losses.

- **High Lapsation Rate:** Low awareness among policy holders and high instance of mis-selling leads to high lapsation rate of Micro insurance policies. Lapsation rate for Micro insurance policies is found to be as high as 80%-90% for some companies. High lapsation of micro insurance policy is also a serious impediment for insurers to design attractive products.

4. Recommendations for Enhanced Rural Outreach and Impact

To realize micro insurance's potential for reducing the rural-urban gap, the focus must shift from traditional models to innovative, tailored approaches:

- **Product Innovation and Simplification:** Develop new, simple, and affordable products with convenient payment terms. A single product covering multiple risks can be highly effective. Simplifying product guidelines will afford insurers the flexibility needed for innovation.
- **Leveraging Community-Based Models:** Since regular distribution models have struggled in rural India, the Mutual Model (community-based organizations) is highly suggested. These are member-owned and have successfully managed health risks, leading to the empowerment of low-income groups.
- **Digital Platforms for Distribution and Service:** Extensive use of digital platforms, mobile applications, and innovative I.T. solutions is necessary to bring ease and scale to distribution, operations, and servicing in remote areas. This includes utilizing video-based settlement (iClaims) and spot liability finalization.
- **Strengthening Distribution Channels:** Utilize trusted grassroots organizations like NGOs, Self-Help Groups (SHGs), and Micro-Finance Institutions (MFIs), who have established trust and connectivity in rural communities. Business Correspondents (BCs) have already proven instrumental in driving uptake for government schemes and can be leveraged for additional products. Creating space for such organisations such as NGOs/MFIs/SHG are dedicated to serve low ticket size market and expected to bring growth to micro insurance market. Similar changes in banking regulations have helped in growth of micro finance sector in bringing financial inclusion. Learnings can be drawn from these experiments in banking sector.
- **Sustained Awareness and Education:** Increase awareness at the household level through all modes of media in local languages, drawing learnings from successful schemes like PMJDY and PMSBY. Incorporating insurance education into the school curriculum and the Skill India initiative for agents will build long-term demand and professionalism.
- **Incentivizing Insurers:** While micro insurance premiums are exempt from service tax for policyholders, similar tax exemptions may be considered for insurers selling micro insurance products to enhance their viability.
- **Segmentation of Micro Insurance Market:** Micro insurance market is considered as a monolith, which ignores the diversity and complexity of needs of the target population. New approach of segmentation of low-ticket market will help in designing relevant product and setting up effective systems for service delivery.
- **Promoting New Age Financial Services/Intermediation Agencies like Payment Banks**
Payment banks are successfully taking financial intermediation to the doorsteps of people. Role of payment banks in increasing access to micro insurance can become a game changer.

5. Conclusion

Micro insurance is unequivocally a powerful, non-negotiable tool for narrowing the vast rural-urban development gap in India. By offering affordable protection against life's unpredictable shocks, it directly mitigates the processes that push vulnerable rural populations deeper into poverty and economic instability. It helps transition individuals from a state of latent vulnerability to one of financial resilience and greater social security.

The core benefit of micro insurance is its ability to facilitate a transition for low-income individuals from a state of latent vulnerability to one of financial resilience and greater social security. It serves as a crucial defence mechanism against social and financial exclusion by preventing the distress sale of productive assets and encouraging households to invest in higher-yield activities

However, the chasm between micro insurance's potential and its current penetration highlights a failure to effectively bridge the demand-supply divide. A sustainable model requires a blend of regulatory support (simplification), technological innovation (digital platforms), and socially-rooted distribution (Mutual Models, SHGs) to overcome the twin challenges of high costs and low trust. Only by pursuing these measures, which prioritize simplicity, accessibility, and fast, transparent claims, can India ensure that the benefits of micro insurance reach every individual, fundamentally supporting the vision of truly inclusive national development.

A sustainable framework for the future requires a strategic blend of measures. Regulatory Support and Simplification to afford insurers the flexibility needed for product innovation. Technological Innovation through extensive use of digital platforms, mobile applications, and I.T. solutions to bring ease and scale to distribution and servicing in remote areas

Socially-Rooted Distribution by leveraging trusted grassroots organizations like SHGs, MFIs, and Business Correspondents, and utilizing the member-owned Mutual Model.

By rigorously pursuing these comprehensive measures—which emphasize simple products, accessible delivery, and fast, transparent claims—India can ensure that the fundamental benefits of micro insurance reach every citizen. This strategic focus is essential for fundamentally supporting the vision of truly inclusive national development

Efforts have been made in last few decades to create awareness about insurance. The focus needs to shift towards increasing knowledge about insurance. So that people take informed decision. We need next generation awareness campaign which will focus on nuances of insurance like types of products, claim settlement process etc. Periodic efforts can be made to remove misconceptions about insurance. Increasing awareness at household level about insurance and social insurance schemes through all modes of media in local language may help in this direction. These awareness programs can also use social marketing concept. Also, learnings can be drawn from schemes like PMJDY which successfully inducted individuals in a short period of time and the total PMJDY accounts has touched a staggering 56.66 Cr by 31.08.2025.

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