

Emerging markets in microinsurance

How to establish a foothold in the new market segment serving low income customers



Low income households feel the impact of adversity more heavily than most in society, yet have little access to affordable insurance products that could help to protect them. However, as insurance providers become increasingly aware of this unmet need, a new microinsurance industry is emerging. To gain a foothold in this market, insurers need to confront a number of challenges: What is the most appropriate operating model for this low-margin, high-volume segment? What type of products do low income consumers want? How can insurance products be distributed in a previously unserved market? Insurers that succeed in overcoming these challenges have the opportunity to tap a potentially vast new source of profit.

Microcredit – the practice of extending small loans to very poor people for self-employment projects – has had an important impact on the ability of the poor (those with less than 60% of median income at their disposal) to rise above the poverty line. But those living at the Bottom Of the Pyramid (BOP) live in an environment fraught with risk. While perils such as illness, accidental death and disability, loss of property due to theft or fire, agricultural losses and natural or man-made disasters affect all of society, they are more likely to strike the poor and, when they do, to have a greater impact. Microinsurance aims to help those at the bottom of the social pyramid to stay above the poverty line even when they are hit by an adverse event. It does this by providing risk protection at very low premiums.

A new market for insurance services

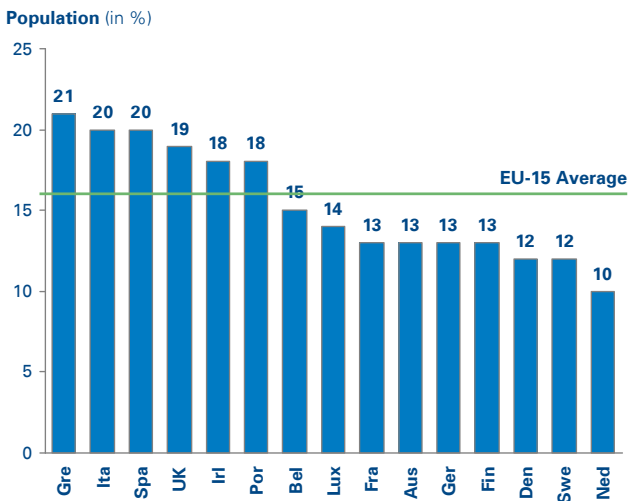
With financial services companies having lost customers' trust as a result of the global financial crisis, and the social trend towards sustainability and responsibility growing steadily, financial service institutions need to find ways to regain customers' confidence and engage with customers in a socially responsible fashion. Microinsurance is one way financial services companies can demonstrate social responsibility and allows them to generate profits as they do. On the one

hand, in the absence of appropriate government schemes, microinsurance extends social protection to the poor and provides a vital financial service to low income households. On the other hand, it requires financial services companies to develop an appropriate business model that establishes low income households as a profitable and sustainable market segment for commercial or cooperative insurers.

According to a recent Datamonitor report, the four billion people around the world who live on less than US\$2 per day represent an annual market for insurance services worth US\$80-90 billion. In addition, low income customers in the developed countries (see figure 1 overleaf) may have a daily income that is slightly higher but face problems that are strikingly similar to those of the very poorest. For insurance providers able to create innovative products that address the needs of these groups this is a significant opportunity.

But what is the best way for insurance providers to service this barely explored market segment? In order to develop new business models for microinsurance and to offer microinsurance services on a large scale, it is necessary first to assess why current insurance models do not reach the poor and to overcome a number of obstacles.

Figure 1: Low income consumers segment size



Source: Arthur D. Little analysis, Eurostat (2006)

Microinsurance business models

The approach used by insurance providers for their traditional customers is not appropriate for low income customers. The low income segment requires particular products and pricing, and also poses distinctive distribution challenges. While the pricing issue is rather obvious, finding a fitting product design and overcoming the lack of technical infrastructure poses a real challenge to bringing the right products to the customers. Arthur D. Little defines three key factors that need to be taken into consideration in the design of business models for microinsurance:

1. The operating model: volume is key

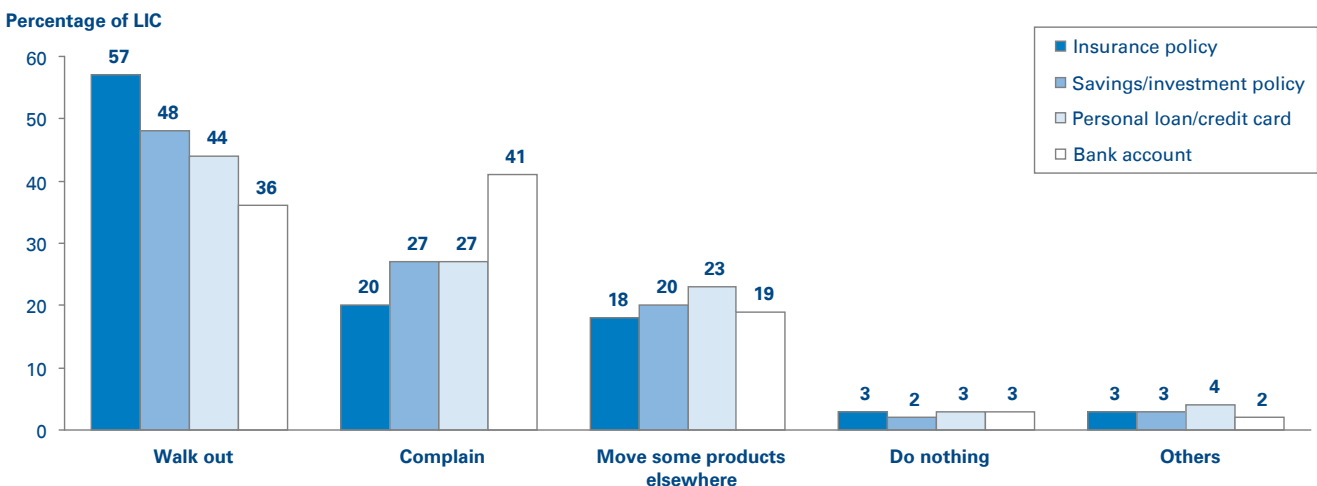
In low-margin business models, volume is the basis for return on investment. Even minuscule per-unit profits can generate an attractive return for shareholders when multiplied by a huge number of sales. This attribute is a perfect fit for insurance and the Law of Large Numbers, which shows that actual claims tend to match projected claims more closely as the risk pool expands. When projections can be estimated with a high degree of confidence, pricing does not have to include a large error margin, making products more affordable.

Service industries are naturally labor-intensive; those focusing on the BOP market are even more so, given the scale of operations. Since labor costs can represent over half of total operating expenses, one strategy to contain costs is to simplify operations so that products can be sold and serviced by less expensive workers. Such an approach is highly appropriate for microinsurance since the targeted customers also want simple, easy-to-understand products.

2. Product design: simple quality at best price

While Low Income Consumers (LICs) cannot afford high prices, they do not deserve poor-quality products. On the contrary, low income consumers demand (and require) a better-quality product (e.g. quick settlement of claims, few if any claims rejected) to overcome their apprehension about paying up-front for an undetermined future benefit. Research shows that if product quality is poor, low income consumers simply walk out (see figure 2).

Figure 2: Reaction to poor-quality service among low income consumers¹⁾



1) For this survey Datamonitor considered low income consumer as all respondents whose annual household income was less than €43,706
Source: Arthur D. Little analysis, Datamonitor Consumer Survey (2004)

Insurance companies cannot simply scale down products and services for low income consumers or propose less expensive versions of traditional products. Understanding how low income households might use an insurance payout, for example, illustrates key differences between the conventional and low income market. Low income consumers tend to prefer in-kind benefits, e.g. funeral service, groceries, possibly spread over a period of time, to a cash lump sum. It is difficult to persuade LICs that they are getting value for their money, especially if they do not claim. Hence cash-back benefits, such as premium-back features, sometimes even with interest, are key to success.

Products and services designed for the BOP market must take into consideration the unsanitary conditions and limited infrastructure, including unreliable electricity supply and poor water quality, that shapes the environment in which the poorest members of society live. As a result, providers of microinsurance may need to invest in loss-prevention measures, such as promoting low-risk behaviour, water purification and hygiene, probably in collaboration with government organisations and/or other external partners, in order to reduce claims for health and life insurance.

3. Distribution: overcoming the access obstacle

One of the challenges of serving the BOP market is getting the product to the customer – and insurance companies are particularly weak at distribution. Insurance providers can overcome this problem by collaborating with organizations that already undertake financial transactions with low income households and leveraging their existing infrastructure to reach the target market (see figure 3).

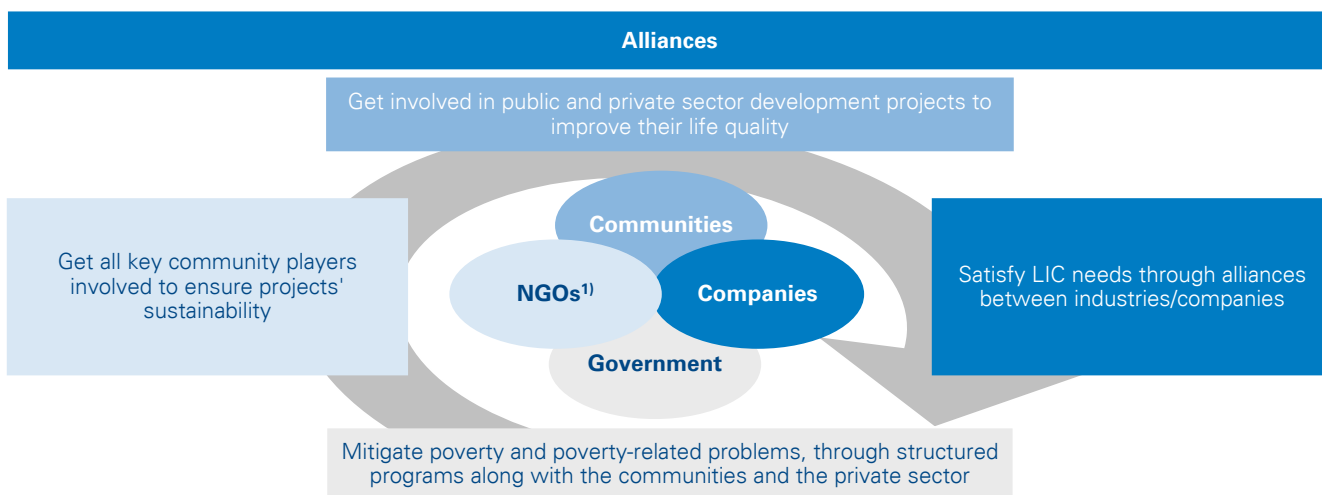
To succeed in microinsurance, insurers need to “create their clientele.” This involves educating potential BOP consumers about how insurance works and how it could benefit them. To do this insurers will need to use innovative mechanisms to reach customers in “media dark zones” which conventional communication mechanisms do not reach.

Creating awareness: the experience of the South African Insurance Association

South African insurers contribute 0.2% of net profits for financial education. The members of the South African Insurance Association (SAIA), providers of non-life and short-term insurance products, have set up a consumer education program that addresses seven themes: money management, budgeting, debt, saving, banking, life and short-term insurance and consumer rights and responsibilities. To raise awareness of the program, SAIA has initiated three activities:

1. “Commuter Net”: with 17.5 million people commuting daily, this population has been identified as a priority target group
2. a teacher resource kit aimed at secondary school students
3. a one-day financial literacy workshop in rural areas (to date, 10,000 people have received the training)

Figure 3: Access via alliances



Source: Arthur D. Little analysis; 1) NGO = Non Governmental Organisations

The heterogeneous BOP market speaks myriad languages and has varying levels of literacy. Insurers serving this market need to consider carefully how to make their services easy for poor households to use. For microinsurance, the application form should be short and perhaps completed by the salesperson. More challenging is the simplification of claims documentation to make it easy for clients to access benefits while protecting insurers from fraud.

Microinsurers will also need to be aware of the range of new technologies that several microfinance institutions are already experimenting with. These include ATMs¹ with biometrics, smartcards, palm pilots and point-of-sale devices, all focused on enhancing efficiency and productivity. Microinsurers should also consider the growing practice of selling insurance products with other financial products, such as loans. "Piggy-backing" the collection of premiums with other financial transactions in this way can deliver attractive synergies.

Conclusion

To serve the low income market successfully, insurers have to think differently about customer needs, product design, delivery systems and even business models. A viable market exists for insurers that are willing to learn about that market and develop new paradigms for serving it. But creating a microinsurance scheme is challenging. Whether a scheme's costs are covered with the assistance of donors and governments, through revenue from premiums or income from investment, sustainability is key. Only by ensuring permanent access to services can microinsurers win their customers' trust. Developing a sustainable proposition depends on balancing three competing objectives: coverage (meeting the needs of large numbers of low income consumers), costs (operating and transaction costs for the insurer) and affordability (price and transaction costs for clients).

The low income market has massive potential if insurers can address these issues with effective innovations. While the obstacles are significant and daunting, they can be overcome. Arthur D. Little can provide the experience and proven methodologies insurers need to establish a foothold in the emerging microinsurance market.

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¹ ATM = Automated Teller Machine