

NOT SO FAST!

TOWARDS REALISTIC GROWTH EXPECTATIONS IN MICROINSURANCE

How fast is microinsurance growing? Yearly growth rates of 10% and more in some countries – and for some programs, as much as 50% – suggest it is booming. But some stories suggest the opposite, for example the African insurer who projected covering 380,000 lives in two years, but after 18 months had managed only 40,000. Still, most who work in the microinsurance sector would agree that numbers of clients are growing, and that there is much innovation going on.

Despite this, outreach and viability remain below projections for many projects. Are they simply underperforming, or is this simply an issue of unrealistic expectations? The answer is, unfortunately, unrealistic expectations. Ventures into microinsurance are too often approached with the assumptions of traditional insurance or those of microcredit. Other contributing factors are the dearth of information on which to base projections, and the professional optimism of proposal writers and business planners.

HOW MICROINSURANCE DIFFERS FROM TRADITIONAL INSURANCE

In microinsurance the core principles of insurance remain the same as traditional insurance, but almost everything else tends to be different, and these differences have important implications for expansion of microinsurance.

Clients and demand. Microinsurance clients are poorer than the traditionally insured, and their incomes are more volatile. They are also more vulnerable to risks such as natural disasters, illness, and death, and they are less capable of mitigating

the financial consequences brought on by these risks. Their need for insurance may thus seem self-evident, but this does not necessarily translate into actual demand for insurance... For one thing, low-income people are used to applying a variety of risk-coping strategies outside of insurance. These strategies range from emergency credit to social capital, precautionary savings, reliance on government and donor support, and the sale of assets. Even though these mechanisms may be insufficient and expensive compared to insurance, poor people often mistrust insurance because of prejudice or perhaps because of past negative experiences. Building awareness and trust among these clients takes more time and resources than many venturing into the market imagine.

Insurers and delivery. On the insurer side, there are usually several constraints in the microinsurance market. These include lack of actuarial data, limited options for distribution, and a need for control adaptations to work within this market.

Reaching financial viability in microinsurance depends on minimal administrative costs and very large numbers of clients (or large groups of clients) who each pay small premiums. Building such a client base and developing efficient processes takes time. To facilitate the process, insurers usually engage a delivery partner who is close to their potential clients. Such collaborations take time to develop, and also come at a cost.

The business environment. Even where there is a demand, supplying microinsurance in the developing world calls for innovative and often unorthodox approaches. One has to take into

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account factors like a weak public sector, limited infrastructure, corruption, and clients who work in the informal sector or who lack proper identification documents. Other challenges might be a lack of insurance experience in the local workforce, and cultural attitudes toward risk which do not consider insurance. Some insurance solutions, such as health, rely on third parties to provide services – a limiting factor in many areas.

Maturity of the industry. The insurance industry has been in existence for hundreds of years. It has developed good data (such as mortality and morbidity tables), specialized skills, and well-trying products. In a mature industry such as this, innovation happens at the margins.

By contrast, the microinsurance industry operates in target markets that have no tradition of insurance. It has to function despite poor actuarial data, and uncertain delivery and control mechanisms. Underwriters may

attempt to curb their risks by imposing exclusions and controls more appropriate to higher income markets. As a consequence of risk ambiguity microinsurance premiums are often heavily loaded, thus affecting product sales.

Most microinsurance ventures require fundamentally novel solutions at several links of the supply chain. For them, there is often no way forward but experimentation. Learning through trial and error, as many microinsurers have to do, slows down the pace of expansion. Some of the lessons learned by other microinsurers could accelerate progress, but these tend to be either inaccessible or ignored by newcomers to the market.

HOW MICROINSURANCE AND MICROCREDIT DIFFER

Microinsurance is often associated in the minds of development practitioners with microcredit, as they both target low-income clients, and many microfinance institutions also sell microinsurance. However, there are fundamental differences between them, and in most cases insurance is significantly more difficult to develop and to sell than credit.

- Credit has an immediate and tangible value, especially for clients with short time horizons and pressing needs. The loan is paid back some time in the future. Insurance, on the other hand, reverses the direction of this cash flow: clients pay in advance and receive a far from certain benefit.

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- Credit is more easily explained and more tangible than insurance, so microinsurers have to experiment to find the best language, formats and channels to reach potential clients. In this market, simplicity and clarity are fundamental.
- In insurance, the client's funds are at risk, unlike in credit where the lender's funds are at risk. Thus client trust is an important issue for microinsurers, and they must convince their clients that they will honor their promises, and do so promptly.
- Distribution channels for microinsurance often involve other parties as microinsurance sales and other transactions must be taken close to the client. Sometimes distribution arrangements are "piggybacked" on existing client relations with trusted institutions. But this comes at a cost, and takes time: processes have to be developed, staff have to be trained, and distribution partners' motivations must be understood and leveraged.
- Insurance may be sold on an individual basis, bought by groups (such as by a firm for its employees), or made compulsory (such as for clients of an MFI). There are pros and cons for compulsory schemes, but they undoubtedly have higher initial growth rates.
- Awareness among potential clients influences the time necessary for an agent to explain and sell a product. Trust, built over time with tangible demonstration, may be as decisive as market education campaigns. However, building an insurance business case on the demonstration effect is a long term process.
- Since many MFIs act as distribution channels, there is a widespread belief that where microfinance flourishes, microinsurance will show rapid growth. In fact, the two sectors show surprisingly limited correlation, and MFIs distribute much less than half of all microinsurance.

Microinsurance is in a different growth phase from microcredit. Depending on how one measures it, microfinance is between 20 and 30 years older than microinsurance. It has had more time to evolve, and more time to co-evolve with its business environment, which includes regulators, donors, financial markets, government, and grass-roots movements. Microcredit's proven business models can be replicated in a variety of cultural environments and markets.

Essential determinants of growth in the microinsurance supply chain: *elements that take time (often underestimated) to evolve.*

INSURER	PRODUCT	DISTRIBUTION CHANNEL	POLICYHOLDER
<ul style="list-style-type: none"> • Market intelligence (demand, data) • Regulation • Reputation • Market for MI skills • Business process technology 	<ul style="list-style-type: none"> • Market adaption • Appropriate controls • Efficient premium collection • Product development process • Claims administration 	<ul style="list-style-type: none"> • Regulation • Client base • Sales skills • Incentives • Motivation • Reliability • Reputation • Business process technology 	<ul style="list-style-type: none"> • Market awareness • Trust in insurance • "Insurance" understanding • Limited income flows • Culture • Demand • Individual, Group, Compulsory

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Microinsurance evolved somewhat differently. From very early, it attracted the interest of commercial insurers, who brought a wealth of expertise from traditional insurance to the sector. In fact, measured by numbers of clients, microinsurance is a bigger industry than microcredit. Nevertheless most microinsurance businesses have to go through prolonged difficulties before showing success.

TOWARDS REALISTIC EXPECTATIONS

What, then, is a realistic break-even period for a new microinsurance business? This question has no easy answer. Over time, benchmarks for realistic time-lines will evolve. In the meantime, the industry needs to document its evolution. Case studies and microinsurance specific data tracking are the essential raw materials for the systematic studies that will provide the much-needed benchmarks. Tracking of Key Performance Indicators (KPIs) will help managers identify problems early on and develop solutions before programs run aground.

Ultimately, how (and how fast) a microinsurance program can evolve depends on its balance of

objectives. Can a microinsurance venture become profitable as quickly as a traditional business, while innovating at the frontiers of markets, having a positive effect on development, and acting as a learning factory? Can client numbers grow fast without putting cost-efficiency and service quality at risk? Priorities will differ: donors may focus on outreach and poverty alleviation, whereas insurers will focus on profitability. This is not necessarily a cause for concern, as long as trade-offs of objectives are explicit, feasible, and clearly understood.

One thing that can be said with certainty is that successful microinsurance programs have to focus on the essentials. They need to be well equipped with expertise, capacity for innovation, stamina for dealing with challenges, and capital to reach viability. They need to make use of good market research to develop the product, and make sure that the message is coming across to potential clients. Finally, they should make sure that claims are paid out quickly. All of this takes time to develop, implement, and perfect, and must not be overlooked in planning microinsurance interventions. Faster growth will come with good preparation of products, markets, and processes. The advance work pays off in limiting the need to make many mid-course corrections. Working with large groups and offering products linked to their purpose can yield more rapid growth. ■

This paper was prepared by Michael J. McCord, Oliver Zenklusen, and Roland Steinmann as a means of prompting further discussion about growth expectations in microinsurance.

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