

BUSINESS CASE FOR MICROINSURANCE (PART II) A FOLLOW-UP STUDY ON THE PROFITABILITY OF MICROINSURANCE

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Can insurers really serve the poor and respond to the interests of their shareholders? Is microinsurance a legitimate line of business or just a socially responsible endeavour? Can insurers do well (financially) by doing good (for clients and society)?

Although insurers are becoming more active in microinsurance and are optimistic about future profitability, questions around whether microinsurance can achieve adequate returns for shareholders need to be explored. Understanding the drivers of profitability and the factors enabling good financial performance is critical to the development of viable microinsurance initiatives.

This brief presents results from an analysis of the financial experience of six insurers (Table 1) over three years, looking at changes to some of their microinsurance initiatives and providing new insights into drivers of profitability. These microinsurance initiatives were first investigated in a study completed in 2010. That study revealed that insurers were facing challenges with profitability and had implemented a



¹ This brief is excerpted from Microinsurance Paper no. 32. The paper is available at <http://www.microinsurancefacility.org/publications>. Janice Angove is an actuary and teaches at University of the Witwatersrand, South Africa and Aparna Dalal is part of the ILO's Microinsurance Innovation Facility.

number corrective measures, particularly in the area of distribution and claims management. This brief investigates whether those measures have been successful over the longer term.

Much has changed during these three years. Most of the insurers initially entered the market with simple products. They developed relationships with distribution partners and gained a better understanding of the needs of the low-income market through these initial product offerings. As they gained success, they expanded their microinsurance portfolios and made extensive investment of capital and human

resources, partly funded by donors. All the insurers have either introduced new products or added benefits to existing products in the last three years. Changes to products focused on meeting the needs of the low-income market and were based on feedback from existing partners or market research conducted by insurers.

The analytical framework from the previous study is used to explore the financial performance of the initiatives, with a focus on three main drivers of profitability: achieving scale, controlling claims costs and managing expenses (Figure 1).

TABLE 1. Insurers and products reviewed

Insurer	Product	Type	Covered lives (1 000s)	Gross written premiums (US\$'000s)	% of overall micro-insurance portfolio	Profitability
Aseguradora Rural (ASR), Guatemala	Life	Voluntary	190	8 130	69	✓
	Student	Voluntary	21	430	4	✓
	Passenger	Voluntary	130	2 550	22	✓
Co-operative Insurance Company, Kenya	Credit life	Mandatory	150	2 870	40	✓ → ✗
	Afya Bora	Voluntary	5	280	4	✓ → ✗
ICICI Lombard, India	W&A	Voluntary (subsidized)	6 380	30 180	21	✗ → ✓
	RSBY	Voluntary (subsidized)	13 730	42 030	29	✗
La Positiva, Peru	Credit life	Voluntary group	40	Not available	Not available	✓
	Water board life	Voluntary group	1.7	Not available	Not available	✗
Malayan Insurance (MICO), The Philippines	Personal accident, property and health	Voluntary	Not available	4 944	100	✓
Malayan Insurance (BAC), The Philippines	Personal accident, property and health	Voluntary	Not available	281	100	✓
Old Mutual	Group funeral	Voluntary group	500	Not available	Nearly 100	✗ → ✓

FIGURE 1. Framework for profitability

Drivers	Achieve scale (new customers and renewals)	Control claims costs	Manage expenses
Strategies	• Partner with existing groups, including governments • Design appropriate products (and allow them to evolve) • Price products appropriately • Balance sales, servicing and retention	• Price for the risk • Manage adverse selection and claims fraud • Manage claims volatility and co-variant risk	• Efficiently use existing infrastructure and resources • Invest in simple processes and efficient technology
KPI	• Covered lives/policy volumes • Premium volumes • Retention ratio	• Claims ratio (including claims expenses)	• Acquisition expense ratio • Administration cost ratio

ACHIEVE SCALE

The majority of the microinsurance products in this study have grown significantly over time, although some have seen variable growth and stagnant or reduced premium revenue. Increased competition has been a challenge to business growth and profitability for the Kenyan, South African, Filipino and Indian insurers although it is encouraging that microinsurance markets are developing in these countries.

The following strategies were identified to achieve scale:

- Partner with existing groups, including government agencies that want to use insurance to achieve policy objectives.
- In competitive markets, differentiate products through benefits and servicing, rather than price, to foster loyalty (Box 1).

- Balance resources between servicing existing clients and generating new business. Both need continuous attention otherwise business volumes decline.
- Use non-financial incentives as well as financial incentives to motivate staff to sell insurance as financial incentives alone are not sufficient to generate large sales volumes.
- Generating sufficient business volumes is important to cover the costs of developing new products, distribution channels and administration systems.

Although some of the products investigated have reached high numbers policies, there is still potential for significant growth, given the market size.

BOX 1. Staying competitive through differentiation

Old Mutual and CIC have experienced challenges in maintaining business volumes, because of intense competition in their markets. In Kenya, profit margins in the credit life market have led to fierce price competition, with a number of insurers offering very low premiums. Rather than matching rates of competitors, CIC has concentrated on enhancing its credit life products with optional benefits like funeral insurance and fire and burglary cover for the asset that is pledged as collateral for the loan.

In the competitive funeral insurance market in South Africa, rather than competing solely on the basis of premiums, Old Mutual is focused on training sales agents and refining processes to enable agents to provide faster sales quotations, and on improving servicing by making it easier for client groups to update membership information.

CONTROL CLAIMS COSTS

Reductions in claims costs have had the greatest impact in transforming the loss-making products studied in 2009 to profitable ones in 2012. Insurers used the following strategies to reduce claims costs:

- Differentiate premiums based on the risk profile of groups. Old Mutual introduced regular monitoring and risk-based premiums for each funeral group. It also stopped the practice of replacing an insured deceased dependant with a new dependant, as the risk of an additional dependant was not priced into the product. These changes have reduced claims ratios from
- Introduce effective claims verification processes to manage claims fraud for health insurance. ICICI Lombard implemented sophisticated claims verification procedures to manage claims fraud (Box 2).
- Use reinsurance for property insurance to mitigate the risk of accumulating claims in areas exposed to weather-related risks.

BOX 2. How ICICI Lombard manages claims fraud

More efficient and automated claims processing has significantly reduced claims costs for ICICI Lombard's Weavers & Artisans health insurance scheme. ICICI Lombard originally used paper claims submitted manually to local branch offices. This system was inefficient and resulted in too much paper and many lost documents. As a result, ICICI Lombard implemented a web-based system that allows healthcare providers to submit claims.

Automation has allowed ICICI Lombard to implement additional claims verification processes, including a trigger system that generates alerts to identify potential fraud (for instance, a health provider with a 15-bed capacity submitting claims for 30 patients on one day). It has also allowed ICICI Lombard to separate its operational and verification functions and create an independent field surveillance and audit team to identify fraud.

These processes reduced claims ratios by 20 per cent and the cost per claim from \$1.3 to \$1.0. The reimbursement time for healthcare providers also lowered from 65 days to 25 days, enabling ICICI Lombard to negotiate lower rates with the providers.





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MANAGE EXPENSES

The third element of the framework relates to expense management. The study focused on acquisition and management costs. Acquisition costs comprise marketing and promotion activities, fees paid to partners, salaries or incentives paid to sales agents and the cost of training programmes for sales agents. Management costs include maintaining and servicing existing policies, and covering company overheads and ongoing management costs. The following factors help manage expenses:

- Negotiate low fees with partners responsible for distribution and administration activities. CIC, ASR, La Positiva and Malayan outsource administration functions to aggregators to reduce premium collection and administration costs.

Although these insurers were able to use partners' existing infrastructure and resources, some investment was required to modify systems and develop microinsurance-specific processes.

- Eliminate duplication of processes, automate processes and anticipate scale. Most of the insurers use automated enrolment processes and web-based systems that link partners (e.g. health providers, funeral parlours) with the insurer.
- Make use of resources from other departments in the company. The microinsurance units at Old Mutual and ASR pay fees to the other departments of the insurer (for example, the actuarial and legal departments) for the use of their services, but this is still more cost-effective than building a skilled team of these staff dedicated to microinsurance.

CONCLUSION

This follow-up research shows that microinsurance has grown in the past three years and that the insurers from the 2010 case studies continue to devote resources to build their microinsurance business. The game is changing because of new opportunities and developments in the market (for example, mobile money) and knowledge gained from experience as the market matures. Monitoring financial experience and keeping in touch with customers are

essential in order for insurers to learn from failures and challenges, and many of them are already doing this.

Although the financial analysis indicates that some initiatives are profitable, assessment of the overall profitability of microinsurance business is more challenging. Microinsurance business is expanding and evolving so even though individual products may be profitable, microinsurance portfolios as a whole may not be. Further research is needed to understand these dynamics.

Housed at the International Labour Organization's Social Finance Programme, the **Microinsurance Innovation Facility** seeks to increase the availability of quality insurance for the developing world's low income families to help them guard against risk and overcome poverty. The Facility was launched in 2008 with generous support from the [Bill & Melinda Gates Foundation](#) to learn and promote how to extend better insurance to the working poor. Additional funding has gratefully been received from [several donors](#), including the [Z Zurich Foundation](#) and [AusAID](#). See more at www.ilo.org/microinsurance



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