MICROINSURANCE: BREAKING THE PARADIGM

José Luis Contreras C.,

Aon Bolivia S.A.

President & CEO

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ABSTRACT

- There is an inherent danger in following models and not question their validity. Looking at the financial crisis, for instance, we believe that however 'elegant' the model was, it was flawed (we now know: trillions later) because we believed that it could quantify risk and by pricing it, we could be deal with it,

- We therefore state that we need a redefined flexible model that accommodates the players to opportunity and risk beyond the constraints of a particular model,

- Reviewing Microinsurance—MI—literature in 2007 we realized that the partner-agent model adopted by many practitioners to spread MI and endorsed by the donor community who looked at MI as another way to help alleviate poverty, had serious shortcomings as it was too schematic as it did not incorporate the role of a market maker that is indispensable for the continuity, sustainability and profitability of the practice,

- We argue that a broker is uniquely positioned to be a MI market maker and explain how Aon Bolivia entered the MI market and through disruptive innovation recreated the MI value chain role creating and capturing value for Micro Finance Institutions—MFIs—and insurers thereby providing continuity and profitability to the practice,

- We also look and explain how a particular stream of donor funds in Bolivia were used to spread MI and why these did not have a significant impact notwithstanding a USD250K plus outlay: because they largely funded ventures following the partner-agent model that in the absence of a market maker who plays a catalytic role in the product design and development, pricing, account administration etc, the practice has no sustainability,

- In explaining the Aon Bolivia model and contrasting it with the partner-agent model we state that MIs lack the distinctive capabilities to take up a MI project more so if the MFI does not have robust administering, marketing and operational skills as most, in Bolivia at least, lack,

- Because of this, we argue that MIs will not take on reputational risk of implementing MI on their own, as the partner-agent model suggests that they will, as that may lead them to lose face with their hard won microcredit customer. The redefined model we propose

closes that gap through a market maker, a broker

- Looking ahead, we understand that MI was envisaged as an obvious continuity of microcredit which achieved scale, penetration, impact and profitability in the late 90s. We state that there is little evidence of correlation between both practices and therefore believe that a market maker is uniquely positioned to provide value to MI as insurers still view MI as a marginal operation and have so far largely offered scale-down products for the MI market,

- In this scenario we state that perhaps, much like the microcredit stand alone organizations that had to be created to take up microcredit when traditional banks for a variety of reasons did not, current insurers will lose the MI opportunity and specific MI institutions will need to be created to provide MI beyond scale down products that insurers currently provide,

- Finally and based in our experience so far, we suggest that donors should not fund the current MI status quo but should redirect their efforts and funds to exploring the strategic lynchpins behind MI rather than follow a schematic model that we believe has outlived its usefulness, like the Philips curve.

INTRODUCTION

Financial institutions were supposed to survive and flourish because they, being rational and by and large traditional, would not risk their very survival by betting on the 'irrational exuberance'[1] of markets and the array of 'sophisticated' and short term profitable financial instruments they churned. Trillions later, we know that this mainstream presumption—articulated and defended by regulators, risk agencies, major international bankers, governments, etc—was wrong.

Risk is inherent in life and in any business opportunity. The issue we face is therefore what to do with it: do we analyze it, measure it, 'understand' it and price it, or do we reduce our vulnerability to it[2] accommodating our business to deal with it and adapt to it? , i.e. do we try and eliminate and / or conquer risk or do we develop a mindset of risk awareness, of understanding its interdependencies and position our company/system to deal and live with risk?

Paul Krugman argues that economists largely converged to a single model besotted by the 'beauty' of the mathematics that could explain 'reality' and, in doing so, mistook 'beauty for truth'.[3] Such was the fascination with the elegance of numbers that according to Felix Salomon[4] there was a single formula that 'killed' Wall Street whilst others argued that entire countries like Iceland became huge hedge funds.[5]

Models therefore seem to carry the seeds of their own destruction as those who adhere to them cannot necessarily determine when their basic assumptions have changed and when those models have outlived their usefulness: witness President George W. Bush stating the fundamentals of the US economy were 'solid' a few months before the financial system imploded.

As entrepreneurs, we therefore need a business approach and mindset that accommodates itself to opportunity and risk, that aligns corporate capabilities to business drivers, leverages the asymmetries in information and seeks relevant sustainability beyond the boundaries of a model, however elegant it currently may be in order to provide sustainability to our operations.

Reviewing microinsurance—MI—literature and position papers in late 2007, we, in Aon Bolivia realized that the accepted model, whilst elegant in the schematic way it aligned MI parties from

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[1] Edmund L. Andrews, *Greenspan Concedes Error on Regulation,* The New York Times October 23, 2008
[2] Nassim N. Taleb, Daniel Goldstein and Mark W. Spintznagel *The Six Mistakes Executives Make in Risk Management*, Harvard Business Review, October 2009
[3] Paul Krugman, *How Did Economists Get It So Wrong?*, The New York Times, September 6, 2009
[4] Felix Salomon, *The Formula that Killed Wall Street*, Wired, March 2009
[5] Michael Lewis, *Wall Street on the Tundra,* Vanity Fair, April 2009

product development to delivery to back office operations, lacked a key driver: that of the market maker. As a result, we stepped in and redefined, in our opinion, MI by aligning cross functional capabilities, investing, experimenting, and risking financial and reputational capital that allowed us to become a market maker providing sustainability to the opportunity.

Whilst the Phillips curve was relevant for many years, following the stagflation of the 1970s, it is still a useful analytical tool but only within a certain set of parameters and hardly a blue print for wage and inflation interaction and long term planning. By the same token, we would argue, the current schematic alignment in the partner-agent model most MI practitioners adhere to may still be relevant in some stages of MI development but, in our opinion, it is not a model that will grant MI the sustainability it needs.

With that mindset and based on our experience, the purpose of this paper is to show that the MI model, as envisaged today by the donor community[6] and multilateral agencies amongst others, needs to be redefined, updated and broadened to include and consider the experience of Aon in Bolivia, that in 20 plus months has managed to develop a profitable and sustainable MI practice based on a modus operandi that is significantly different from the model the donor community proposes and endorses.[7]

Finally, by explaining how Aon in Bolivia tackled MI and developed a sustainable business model, we will attempt to show that the model can be replicated successfully in other territories and that a broker, even the largest multinational one, traditionally engaged in large and corporate insurance programmes, can benefit from this opportunity whilst providing critical value in every stage: design, product implementation, marketing, distribution, claims handling and product innovation.

THE MODEL

Traditionally, the role of the insurance broker in MI has been largely ignored because it was, mistakenly believed, in our view, that it added cost to already low premiums whilst providing little value since insurance companies could team up directly with delivery channels—microfinance institutions (MFIs)—and provide their product line directly to their members/clients. In fairness, it was brokers generally that also articulated this position, unaware of the conceptual flaws their argument carried in light of the opportunity MI carried for them.

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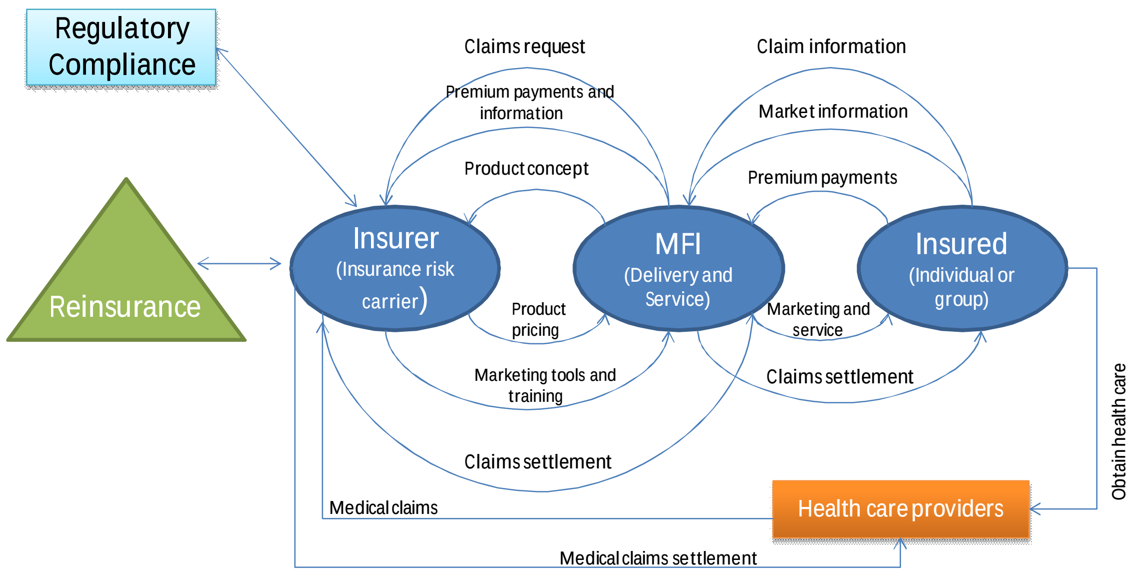
[6] See Appendix 1: "Microinsurance: What it is and why it Matters to Donors" Taara Chandani, *Lessons Learned and Recommendations for Donors Supporting Microinsurance*, September 2008 , http://www.microinsurancecentre.org/UploadDocuments/LESSONS%20AND%20RECOMENDATIONS%20FOR%20DONORS.pdf

[7] See figures to June 30, 2009 in Appendix 2

In this model, MFIs would "gather information from its clients to create a detailed product concept that directly satisfies their clients' real demands. Once there is a clear product concept, the MFI then identifies an insurer to offer the product"[8] as graphically shown below[9]:



By following this conceptual framework, MI practitioners and traditional brokers boxed themselves in the status quo mindset where " - ... existing players ... have resources, processes, partners and business models (and) this makes it difficult and unappealing for them to challenge the prevailing way of doing things"[10]. In this constrained playing field and mindset, brokers believed they did not have enough critical mass or brokerage to want to develop opportunities whilst insurance companies peddled with the opportunity scaling down their product line—thereby defining MI in terms of scale, <u>not</u> operations—as they first sought to 'understand' the business whilst MFIs provided their clients with limited MI products and the uptake on voluntary MI products was limited.

Last, but by no means least, the donor community financed ventures in Bolivia that basically sought to match insurance companies with MFIs and make the partner-agent model grow without necessarily exploring and questioning alternatives. A 2005 Inter-American Development Bank (IADB) financed project[11] states, for instance, that there is a demand for MI, that insurers and MFIs are 'interested' in the opportunity and that in order to jumpstart the initiative in the Bolivian market, four components

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[8] Michael J. McCord and Jim Roth, *Partnerships: Microfinance Institutions and Commercial Insureds*, The Microinsurance Centre, Microinsurance Note 3, January 2007
[9] *ibid*
[10] Clayton M Christensen, Heiner Baumann, Rudy Ruggles and Thomas M. Sadtler, *Disruptive Innovation for Social Change*, Harvard Business Review, December 2006
[11] Project Abstract, *Promoción de Microseguros para Microempresarios*, The Multilateral Investment Fund, http://idbdocs.iadb.org/wsdocs/getdocument.aspx?docnum=1791588

needed to be addressed: marketing MI, identification and development of new products, premium subsidies and changes in regulatory framework.

To this end, sums in excess of USD250K were granted to different projects that almost exclusively sought insurance company - MFI linkup. Regretfully, more than eighteen months later after these grants were awarded to 11 different projects, the results have not been made public or published but it is our understanding that they are poor: 60% of projects provided no significant MI results (despite a very low threshold that the IADB project sought: 30,000 policies), 20% had limited impact, with only the remaining 20% being successful, we would argue, because a broker was involved.

Notwithstanding this, draft regulation was submitted to the insurance regulating body in Bolivia by the same institution that channelled the IADB aid—Centro AFIN—that pretended to bar brokers from MI. This institution argued, mistakenly in our view, that newly created MI agents should replace brokers as they (the MI Agents) would be able to bridge the "asymmetry in information between the MFI and the insurance companies" [12] for all insurance covers that fit a certain distribution criteria including maximum premiums of a monthly minimum salary.

Regretfully, this proposal carried no empirical data or analysis to justify or explain their position, let alone follow the International Association of Insurance Supervisors' recommendations on MI regulation that states amongst various issues, that regulators should understand MI strengths and opportunities in their jurisdiction, improve market efficiencies, promote a national dialogue on the issue and that institutions operate on a level playing field.[13] Having been proposed by AFIN who relies on donor funds, we assume that the donor community has approved this proposal as it fits squarely on their MI vision: direct insurance company MFI linkup, MI agents to 'correct' asymmetric capabilities each player has, and regulation to improve the delivery of both the product and the servicing behind the product amongst other proposals.

BREAKING THE PARADIGM

Given our understanding of the insurance market, when we approached the MI opportunity in late 2007, we realized that MI, or indeed any other insurance product, is much more than the creation of a joint venture between an underwriter and a delivery channel, and the levelling of 'asymmetries' through an agent or advisor to exploit a commercial initiative.

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[12] Erick Schulze, *El Papel del Asesor en el Desarrollo de Microseguros*, 4th Microinsurance Conference, Cartagena de Indias, 2008

[13] International Association of Insurance Supervisors, *Issues in Regulation and Supervision of Microinsurance,* June 2007

Our first approach was therefore to question if the partner-agent model made 'sense' to us. Taking the model apart to understand the components we realized that there was a key catalytic element missing. Who would be the driving force between the opportunity and the product deployment in an incipient market where insurers thought they were active in the trade simply by downsizing their product (reverse innovation)?

MFIs had no distinctive capabilities—"processes to integrate, reconfigure, gain and release resources, to match and even create market change ... the organizational and strategic routines by which firms achieve new resource configurations as markets emerge, collide, split, evolve, and die"[14]—to administer the programmes let alone develop products, and clients were expecting a value proposition beyond stripped down traditional insurance products and we therefore objected to the assertion that the partner-agent model "is most effective when each party performs the tasks it is best at, thereby maximizing operational efficiency"[15] because MFIs had could perform very well micro<u>credit</u> and there was no evidence that these skills would or could be extended to MI automatically or just because MFIs wanted to.

In our experience, product development relies heavily on pre-launch and implementation risk and how those risks are handled and by whom. In our view this is essential to the product's success as it identifies a principal stakeholder and market maker who takes on product design, the creation of a favourable marketing environment, secures funding from the delivery channel (MFI), carries out beta testing, redefines the product, negotiates and renegotiates with underwriters showing them the magnitude of the opportunity in the long term and takes failures as learning experiences so that learning-by-doing becomes part of the model where the insurer and the MFI share the same vision as presented and articulated by the broker.

If "sensemaking involves the ongoing retrospective development of plausible images that rationalize what people are doing"[16] the current model made no sense to us as it was brittle and appeared unsustainable if the enthusiasm for the opportunity waned following, for example, poor results or incremental opportunity costs, making insurers walk away from the practice. If MFIs found out (soon enough) that they did not have the organizational resources to administer the programmes, they would revert to defending their own core business rather than exposing themselves to being identified by their hard-won micro<u>finance</u> customer as a provider of a product they did not understand or control.

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[14] Kathleen M. Esienhartd and Jeffrey A. Martin, *Dynamic Capabilities: What are They?*, Strategic Management Journal, 2000

[15] Nidia Hidalgo Celarie and Pedro Valdez, *Microinsurance in Latin America,* Micro Enterprise Development Review, IADB, June 2005

[16] Karl E. Weick, Kathleen M. Sutcliffe , *Organizing and the Process of Sensemaking* , Organization Science July–August 2005,

MFIs exist to deliver finance to market segments that have been ill-served or ignored by traditional financial institutions. Very few have organizational capacities and execution expertise beyond their core business and are lean organizations that struggle to compete in their sector: loans for women, micro entrepreneurs, low income farmers etc. Their organizational capabilities are pretty basic and are therefore unlikely candidates to delve into MI and learn a trade and experiment with their own hard-won clientele. This reality clashed with the expectations that the partner-agent model had with regard to the MFI: that they could create "a detailed product concept that directly satisfies their clients' real demands." [17] Moreover given their specialization, we understood that MFIs would not only not develop MI products but if they somehow did, they did not have the skills and negotiating abilities to identify an insurer as the partner-agent model suggested they would or could.

Based on this premise, we believed that the Insurance Supply Chain[18] as applied to MI, between a risk carrier, administrator and distributor, needed to be reinvented in order to bring to MI in Bolivia, sustainability beyond the "fad" and experimenting stage that the market was in at the time, financed in part by, in our opinion, misguided if well intentioned donor funds.

Whilst the conceived MI value change is linear where each part is supposedly aggregating value—risk carrier, administrator, intermediary, customer—supported by technology[19], in our redefinition of the value curve, we took on a multidimensional approach where value is orchestrated, where unsatisfied customer demand is explored and the company taking the initiative commits tangible and intangible assets and resources to this endeavour, not by following rigorous methodologies or propriety scientific breakthroughs,[20] but by testing the market and learning-by-doing.

In this context, analyzing the market, players and product development, we realized that we had to change significantly the way we would operate and how the other relevant players would be aligned. Perhaps had we been players in the MI market we may have gone for incremental change where the product is improved through content or improved delivery and/or scaling. Since the partner-agent model excluded brokers from the practice, and the local market took the partner-agent model as a blueprint for success more so if financed by the donor community, we had to elbow our way in through disruptive innovation attacking the market from the sidelines, changing the player's

[17] Michael J. McCord and Jim Roth, *op.cit.,*

[18] Michael Chu and Jean Steege Hazell, *Micro Insurance Agency: Helping the Poor Manage Risk,* Harvard Business School, April 2007

[19] Taara Chandani, *Op. cit.*

[20] Alejandro Ruelas-Gossi & Donald N. Sull, *Orequestación Estratégica La clave para la agilidad en el escenario global*, Harvard Business Review America Latina, November, 2006

alignment, initially assuming a huge dosage of operational and reputational risk, and creating an entirely new market dynamic.[21]

We therefore began entering the market by qualitatively and quantitatively analyzing the target MFIs portfolio and developing beta products. Most of the MI literature emphasized on getting the 'right product' in order to get into the market, suggesting that market research be used to find out what the MFI's clients need and expect and that based on these surveys, products be developed, priced and distributed.

Whilst we appreciated the sequential logic behind this idea we realized the serious limitations this approach had, as customer preference-tools are, in our opinion, "blunt instruments"[22], more so in MI because, as a new industry and as pointed out by Craig Churchill,[23] it faces issues of terminology, of defining a product that prospective customers do not understand, negative preconceptions of insurance, heterogeneous character of low income segment in terms of age, gender, family composition, the heightened expectations that may results from the objective markets caused by surveys, focus groups etc.

Clients will not suggest or demand what is not there in the same way clients could and did not demand or envision an Ipod or Post-it Notes before they were launched. Following what clients state they 'want' leads, at best, to incremental improvements, momentary price/product advantages possibly through scaling or other means, but not revolutionary improvements, exponential value propositions or sustainable advantages that would secure cash flows to pay for further product development and therefore secure sustainability.

Aon's disruptive innovation did just that when launching its MI initiative. We would develop products based on intuition, some market research but fundamentally by trying out ideas with MFIs. We would price risk and then go to underwriters who would not necessarily understand the mechanics of the pricing or operation but would decide to support it because they too could be part of the learning process as we launched the beta versions that were subsequently tweaked and from which we would learn by doing.

Why did MFIs listen and talk to us? Mainly because we had a reputation of being a lead player in insurance broking but fundamentally because they realized that we spoke their language, understood

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[21] Clayton M. Christensen and Michael Overdorf, *Meeting the Challenge of Disruptive Change,* Harvard Business Review, March-April 2000
[22] Eric Almquist and Jason Lee, *What Do Customers Really Want?,* HBR.org, April 2009
[23] Craig Churchill, *Trying To Understand The Demand For Microinsurance,* Journal of International Development, 2002

their sector, partnered with them and showed them that we would run with the financial outlays, operational and reputational risk in the trial stages of product launch. Because our deployment strategy was also prudent we began delivering MI products in a scale that would not compromise a significant proportion of the MFIs portfolio.

Contrary to proponents who argued that it would be MFIs who would want to engage in MI, "with little additional risk",[24] and that MFIs by virtue of their captive clients would therefore earn additional income with "little additional effort"[25] we understood that MFIs would not expose their hard won clientele to products they (MFIs) did not understand let alone control and therefore had to leverage our reputation to give them the initial comfort factor as well as building into the price structure a contribution to pay for the MFI providing us with their client base as "self-interest is still the best motivator we know – or more accurately, the only consistent motivator".[26] MFIs would therefore not run huge reputational risks with their clients if the MI products stumbled given initial scaling and yet they could earn non-operational income from MI and begin to learn the business.

Central to our model was also the assignment of risk capital to the project and fine tuning initial results so that these become clusters from which new by-products can spring from therefore guaranteeing both continuity and sustainability. Our emphasis was not on defining the product, but rather the business model that can best adapt and supply the product because clients don't know what they want[27] and asking them only skews creative output.

By approaching the challenge in this way, we controlled the product delivery, were in charge of tweaking it as well as suspending rollover if results justified that action or of upgrading or downgrading deliveries to better fit the customer's expectations.

In summary, Aon Bolivia would approach an MFI and begin a dialogue with them of what their portfolio was and what they envisioned as growth areas. We would make an argument that they could seek differentiation from their competitors through MI and also generate non operational income that would go straight to their bottom line. We assuaged their operational and reputational risk fears by showing them that our launch would be well monitored by their marketing personnel and that we would finance most product development costs.

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[24] Michael J. McCord, *The Partner Agent Model. Challenges and Opportunities,* in Craig Churchill (ed)., *Protecting the Poor, A Microinsurance Compendium,* 2006

[25] Jim Roth, *Micro Insurance in Latin America and the Caribbean: Achieving Sustainable Scale – What Role Can Donors Play,* Micro Enterprise Development Review, IADB, July 2006

[26] Paul Krugman, *The Conscience of a Liberal,* The New York Times, October 6, 2009

[27] Alejandro Ruelas-Gossi, *La Paradigma de la T grande. Innovar en Mercados Emergentes*, Harvard Business Review America Latina, March 2006

We would then analyse their client structure in terms of distribution of loans by age, gender, amount, rotation, ability to pay, and if possible other available data and propose to the MFI working with them to develop certain products that would fit their clients. The focus of our dialogue moved from the CEO or CFO to the marketing team where we would outline the marketing plan, distribute launching costs etc., determine a launching timetable, guesstimate initial expected sales figures etc.

We would then have a dialogue with the operations persons at the MFI to ascertain the best way to get premiums paid and the protocols that needed to be established so that clients are registered, premiums collected, paid and losses reported. In some instances, Aon would take up much of the back office work or administration' of the product even paying claims out of their funds to service claims promptly and then get a bulk refund from insurance companies every two weeks or on a monthly basis.

Having pre-established a product, an initial target market segment, pre-determined a market strategy we would then approach underwriters with a price range for the product, policy wording and aggressively market the risk/opportunity until we struck a deal with an insurance company willing to write the risk at our pricing, terms and conditions and if possible made them finance part of the marketing costs.

We would also train MFI personnel on the products and their characteristics as well as advise them how to sell it and how to follow up on leads and prospects and how to control their sales pipeline.

After launching the product we would establish controls on what the initial uptake was and how the launch had resulted from original expectations. We would then have dialogues with the MFI marketing personnel to see how their clients had responded and from that learning we would tweak and adjust necessary product attributes and/or the modus operandi of the sales cycle or the back office chores. As soon as the products had traction, we would try and enhance our operational efficiencies and try and start developing new variants to products that had already begun to show a steady income stream.

Whilst the initial thrust was on credit-related MFI activity both on a mandatory and voluntary basis, we soon moved to stand-alone products such as micropensions (*renta doble*) where a client would save over periods of 7 to 10 years a certain amount and then the MFI would return twice the saved amount in an equivalent time period as the savings one. This product caught on with informal and independent workers and had insurance products attached to take care of death and or disability in the saving period. Initially the financial risk was taken up by the MFI who looked to the product as a long term and low cost funding mechanism. Currently, we have been successful in developing a financial model where the insurer takes up both the financial and death and disability risks therefore generating price efficiencies and allowing us to market the product beyond MFIs.

This is an example of our successful value orchestration, where existent knowledge was put to use and developed in a non-existing market that was explored to yield a product, a solution and secure future cash flows around a plausible and sustainable orchestrated architecture: the different risks, the financial model, the ability of this product to secure inexpensive long term funds to MFIs, etc. The innovation we undertook was a way to create and capture value[28], in an environment that was incipient, misguided and therefore fertile for our type on intrusiveness: where insurers looked at MI as a marginal operation, MFIs had no competencies as argued previously and yet there was an unattended market ready to be exploited: a wonderful opportunity for a company like Aon who could secure the capital, align its distinctive capabilities and orchestrate a business and where each party leverages on theirs with the insurance company underwrites the risk, the MFI participates in marketing, aligns the product to their needs and generates non operational income and Aon develops, price, administers and markets the product.

Contrary to exploiting and aligning these competencies, the partner-agent model aligned responsibilities in the insurance supply chain that presumed that these competencies would be developed by MFIs when in fact, at least in the Bolivian case, there is little evidence that the MI opportunity would lead them to develop non-core competencies by engaging in MI product design, marketing, etc., etc. Indeed, a much publicized success story of the partner-agent model in Bolivia with an MFI that has strong organizational skills, has already begun a dialogue with Aon as they will discontinue being involved with an issue that is not part of their core business and therefore wish to have us take care of their MI lines.

Looking ahead, with fewer foreign remittances and an impending economic slowdown we believe that most MFIs will concentrate on updating and/or realigning their business model to factor in these adverse circumstances. In our opinion and experience, there is therefore even less little fertile ground now for MFIs to engage in MI on their own as most MFIs will use available resources to defend their core business rather than explore non-core opportunities and thereby risking their client base as discussed earlier.

Interested parties will argue that the MI agent and or assessor can help in reducing product and industry asymmetries and therefore reduce the inherent operational risk any new product/venture has. We contend that this claim is wishful thinking at best, mistaken at worst. The former because it

[28] Donald N. Sull, Alejandro Ruelas-Gossi and Martín Escobari, *Innovating Around Obstacles,* Harvard Business Publishing, December 2003

assumes agents/assessors have attributes they do not have, and the latter, because they assume the MFIs would fund risk capital that they would clearly want to use in their own core business, especially in economic downturns.

Agents can help product delivery and socialize it in their communities amongst other things, but cannot, in our opinion, leverage their weight with insurers in order to speed-up loss payments, improve operations and/or allow product changes as soon as these are needed. This is due mainly because they do not have the commercial might a broker may have to influence the insurance market nor are they delving in insurance everyday and therefore knowledgeable of what the alternatives are to move business from a non-performing carrier to another one and therefore save the MFI from losing face with its clients who are not being serviced adequately with their MI.

Agents and/or assessors whilst they may be knowledgeable in determining the technicalities of a product because they are generally learned individuals; do not necessarily have the funds to commit to product testing and/or research and/or marketing costs a new product launch entails and demands whilst a broker can and, in the case of Aon Bolivia, does.

Finally, in our opinion, agents and assessors want to carve themselves a monopoly over MI, in Bolivia at least, and would have as their offerings training capacity to the MFIs in MI and be able to pick out the best carrier for any given product. We question the validity of this assertion on two grounds:

1. What is their experience in negotiating with insurers and committing them to the whole life span of a product when their interaction with insurers would be limited to MI which is hardly a major line of business for any insurer but rather an experimental and marginal one?

2. In the event of a proven misrepresentation and an insurer claiming and error and omission by the agent and/or assessor, what backing does the individual agent have to indemnify the claimant in the absence of Errors and Omissions insurance?

LOOKING AHEAD

In 2001, it was argued that “Leading microfinance institutions are gradually moving away from a ‘product-focused’ mentality towards a more holistic, integrated view that looks at the full spectrum of financial services required by low-income households, not just microentrepreneurs. If properly designed, this range of services—especially savings, credit and insurance intended to help clients manage risks—will hopefully result in a more complete, lasting break from poverty."[29]

Somehow in this drive towards focusing more on clients than in markets segments or products, there was a presumption that MFIs would graft dynamic capabilities of insurance product design, administration and broking capabilities into their DNA and that by following the partner-agent model that we were told "eliminates agent risk and allows the institutions involved to focus on their particular strengths,"[30] MI would flourish following marketing campaigns and adequate demand and product surveys and even subsidies as suggested by the referred to 2005 IADB project.

This sequential approach to market development is Rostovian[31]. Based on our experience in Bolivia, we have seen no evidence of these capabilities developing in MFIs and quite the contrary because of their absence, Aon has been able to redesign the local MI industry, positioning a broker as a market maker and stakeholder driving product innovation and realigning insurers and MFIs to actually exploit their particular and actual proven strengths.

Whilst the attractions of providing low cost insurance to more than four billion people at the Bottom of the Pyramid—BOP—that may be life changing/saving for them makes the MI proposition an attractive one, the fact that consumer bias—the tendency to overvalue the benefits of a current consumption and undervalue the benefits of the new alternative, like MI[32]— is still inherent in the purchase and has to be dealt with, in our opinion, a schematic partner-agent model will not crack this issue or the product design issues, marketing or operational ones that arise in MI because these partners understandably rely on their own current capabilities and attributes as opposed to the intrusion of a market maker as suggested, who is willing to explore the opportunity, innovate and capture value as discussed above.

Whilst the differences in organizational beliefs about the environment between current mainstream MI writers and ours should be obvious, it would seem that the current MI environment was envisioned and constructed around microfinance experiences and their actors yet there is little evidence that the two disciplines actually correlate (in Bolivia at least) for the reasons we pointed out. We can therefore explain the dissonance between how we, at Aon, saw the opportunity against the mainstream model in

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[29] Churchill, *op. cit.*

[30] Stefan Dercon, Tessa Bold, César Calvo, *Insurance for the Poor?,* Inter-American Development Bank, Sustainable Development Department Technical Paper Series, August 2006

[31] W. W. Rostow. *The Stages of Economic Growth: A Non-Communist Manifesto,* Cambridge University Press, 1960

[32] John T. Gourville, *Why Consumers Don't Buy: The Psychology of New Product Adoption,* Harvard Business School, April 2004

terms that there are different realities depending on the questions you ask, [33] the important issue being how relevant and sustainable is your perspective and weather it is not confusing hindsight with foresight.[34]

Donor funds helped the partner-agent model embed itself in Bolivia with little demonstrated positive impact. Indeed, there are still exponents who suggest that the donor community should work with existing insurers, facilitating their entry to low-income markets with time bound conditional support, and even upgrade financial and management capacity of insurers[35].

In our opinion, by targeting funds to traditional stakeholders and operators they are, at best, funding sustaining innovation as opposed to disruptive (game changing) innovation which MI needs in order to firmly establish itself in the market, and at worst, they are funding the status quo as indicated by Christensen *et.al.*[36]

We would therefore suggest that donor funds are devoted to understanding the strategic alignment that is needed for MI to flourish and become sustainable beyond low-hanging-fruit opportunities[37] the partner-agent model has capitalised on. Through a more comprehensive strategic analysis we should envision and articulate the lynchpin that is needed for enduring value propositions that break away from the erroneous belief that because microcredit was successful MI, as an extension, should follow the same fortunes.

Multinationals mistakenly believed that the developing world could be a great "new market for their old products,"[38] where First World product extensions would do, only to realize many years later that they had to rethink their business models based on greater cultural sensitivity and new ways of thinking and accepting that the "imperialist assumption that innovation comes from the center will gradually fade away and die"[39]

MI as an extension of microcredit has conceptual shortcomings that in the absence of a market maker as our experience has shown will probably have limited impact: "Once micro insurance becomes

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[33] Richard L. Daft and Karl E. Weick, Towards a Model of Organizations as Interpretation Systems, in Karl E. Weick (ed) *Making Sense of the Organization*, 2000
[34] Nassim N. Taleb, Daniel Goldstein and Mark W. Spitznagel, *op.cit.*
[35] Chandani, *op. cit.*
[36] Clayton M Christensen, Heiner Baumann, Rudy Ruggles and Thomas M. Sadtler, *op.cit.*
[37] It is estimated that MI covers through insurance companies cover only 38 million customers in the world's 100 poorest countries, see Taara Chandani, *Microinsurance Business Models,* Premier Series on Insurance, Wordl Bank, April 2009
[38] C.K. Prahalad and Kenneth Lieberthal, *The End of Corporate Imperialism*, Harvard Business Review, August 2003
[39] *Ibid*

more established, it will also be facing many of the same issues that micro lending does today—notably questions about whether it is indeed helping to lift people out of poverty. In micro lending, the jury is still out (our emphasis)."[40]

We have already seen evidence that the more established and larger MFIs are beginning to look at handling the underwriting themselves given the shortcomings they find in the insurance industry and are asking themselves if they need to transfer risk specially for high frequency low severity cases, e.g.: credit life, life products tied to savings, etc.

The issue was formally raised in a May 2009 meeting on microcredit hosted by the Corporación Andina de Fomento, a regional development bank, which came on the heels of the lifting of mandatory credit life covers for financial institutions in Bolivia, i.e.: MFIs, banks etc can now decide if they take credit life risks on their balance sheets or transfer it out to the insurance market.

If this is the way forward and if MI players realize that MI, for all its deliverables and potential may operate mainly on a subscale eluding profits and that "there aren't many takers"[41], and that the gold at the Bottom of the Pyramid is either a "harmless illusion or dangerous delusion,"[42] all the more reason why we should critically look at MI and reassess what we are doing even if this means that we have to go against the status quo and in doing so, ruffle some feathers.

[40] Knowledge@Wharton, *Micro Insurance: A Safety Net With Too Many Holes,* Forbes.com, October 10, 2009
[41] Barbara Kiviat, *Why The World's Poor Refuse Insurance,* Time Magazine, September 21, 2009
[42] Aneel Karnani, *The Mirage of Marketing to the Bottom of the Pyramid: How the Private Sector Can Help Alleviate Poverty,* California Management Review, UCLA, Summer, 2007

APPENDIX I

Microinsurance: What It Is and Why It Matters To Donors

Microinsurance is the provision of insurance services to low-income people, who typically do not have access to insurance or adequate social security services. The key distinction between microinsurance and traditional insurance is the market that it seeks to reach. Microinsurance is basically managed according to insurance principles and funded by premiums.[1] It can cover any risk that is insurable at a reasonably affordable cost, including illness, accidental injury, death, and loss of property or crop. Coverage can be offered as a single or bundled risk product, and it can also be provided on an individual or group basis.

Microinsurance shows enormous potential as a risk-pooling mechanism to protect the poor from risks and adverse events. Without access to insurance, poor people have to draw on limited resources at hand to meet unexpected and potentially devastating losses. Through the payment of small, regular premiums, poor households can protect themselves against the uncertain prospect of financial shocks. Microinsurance, provided by formal or informal insurers, can complement the state's role in providing social protection by reaching vulnerable groups, and it can also help stimulate regulated insurers (especially commercial) to serve the low income market.

Coverage of social protection services is dramatically low in developing countries, with national governments unable to afford or administer universal care.[2] Based on estimates from the ILO, no more than 20 percent of the active population in many developing countries is included in public social security systems. The situation is especially severe in sub-Saharan Africa and South Asia, where only 5 to 10 percent of the working population is covered by statutory social security—primarily old age pension and access to health care (ILO, 2001). Privately provided insurance is starting to fill this gap but there is limited data on the exact scale of penetration. The Microinsurance Center estimates that 78 million people in the 100 poorest countries have some microinsurance coverage (Roth, et al. 2007).

Donor attention and support to microinsurance is recent, but it is growing in popularity. Microinsurance is seen as an important tool to help poor communities manage their risks, reduce their vulnerability, and build their asset base, thus supporting the achievement of the Millennium Development Goals. While there is limited evaluative evidence of the success of microinsurance models or its impact on clients, there is accumulating practical evidence of good and bad practices that can inform future programming.[3] The need for donor coordination, strategic innovation, investment in public goods, research and impact measurement, and sharing of best practice is both timely and critical in this emerging field. Ultimately, donors are well positioned to bridge traditional social protection with financial sector or market-driven approaches to ensure better coverage for more low-income people.

To date, major contributors in this field include International Labor Organization (ILO), the Department for International Development (DFID), the German Development Cooperation (GTZ), American International Group (AIG), the Swedish International Development Cooperation Agency (SIDA), the Ford Foundation, the World Bank, CGAP, Opportunity International, the Bill and Melinda Gates Foundation and Asian Development Bank, among others. According to a survey by the Microinsurance Center, there were nearly 160 donor funded projects in place between 2003 and 2006 (Roth et al. 2007). This study estimates that the total donor contribution to the sector was just above US$10 million over the three years. Given that most donors do not publicly distinguish microinsurance from other portfolios, this probably does not capture all donor-supported programs. Overall, donor involvement and thinking about this sector is still at an early stage.

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[1] Based on the definition used by the IAIS-CGAP Joint Working Group, in Issues in Regulation and Supervision of Microinsurance, 2007.

[2] Social protection includes public social security schemes as well as private or non-statutory schemes-such as mutual benefit societies-that are not wholly determined by private market forces (Jacquier et al 2006).
[3] The CGAP Working Group on Microinsurance, with support from SIDA, DFID, GTZ and the ILO, launched a project in 2003 to document the experiences of microinsurance operations around the world and identify good and bad practices. 24 case studies were conducted, documenting the lessons of more than 40 organizations.

APPENDIX II

AON BOLIVIA S.A.

18 MONTHS OF MICROINSURANCE

	2008				2009	
	1Q	2Q	3Q	4Q	1Q	2Q
Insureds in thousands	57	60	63	59	70	92
Sums Insured in 000s USD	100,114	101,379	114,916	116,004	141,361	218,159
Earned premiums by insurers in 000s USD	71	164	270	395	531	759
MFI margins paid in 000s USD	10	23	36	51	72	112
Number of losses paid	25	58	73	97	134	161
Total amount of losses paid in 000s USD	51	134	191	252	354	421
Number of MFI working with Aon	5	6	7	10	9	12