

STRATEGIES FOR SUSTAINABILITY

The sustainability dilemma comes down to a trade-off between three competing objectives for a real value product:

- **Coverage:** meeting the needs of large volumes of low-income people
- **Costs:** operating costs and transaction costs for the insurer, and
- **Affordability:** representing the price and transaction costs for clients.

As a business develops and grows, achieving a regular flow of income, it has to balance a set of three competing interests to be successful:

- **Employees** to get the best compensation
- **Customers** to purchase the product at the best price
- **Shareholders** to receive the best return on their investment (whether in financial or social terms)

This note summarizes the main strategies to achieve sustainability, divided into three categories: a) **limit benefits**, b) **focus on efficiency**, and c) **diversify income sources**.

Limit benefits

Microinsurance programmes usually take longer to reach viability than other insurance schemes. To achieve sustainability, these programmes can offer basic benefits at the start. Once the surplus reaches a pre-determined amount and the scheme is financially stable, the funds can be used to increase customer benefits. The downside of this approach is that it may not cover the risks that the low-income market are most concerned about, and early policyholders may be over charged.

Another way of limiting benefits is to put a ceiling on the amount that will be paid out over a period of time, or **cap benefits**. This benefit ceiling reduces claims volatility and hence reduces the need for reinsurance. However, this approach may not solve the greatest need of microinsurance, i.e. helping the poor cope with large losses.

If the low-income market cannot afford comprehensive coverage, then it is necessary to **target certain benefits**. For example, benefits can be designed to fill key gaps (e.g. pharmaceuticals) in the existing mechanisms for coping with risk. It is best to involve the target market in choosing the benefits to allow them to decide how much they are willing to pay and for what.

Otherwise, microinsurers are likely to experience low renewal rates if clients are not covered for risks they face.

Microinsurers can choose to focus on **big-ticket** items – high-cost, low-probability losses such as hospitalization. This approach, however, fails to address primary care, which has the greatest impact on improving overall health and reducing total health expenditure.

Focus on efficiency

Another approach to sustainability is to minimize costs through more efficient and effective products, systems, and processes.

Many microinsurers use group insurance to maximize efficiency. For example, the **member-benefit** approach is one of the most effective ways of minimizing operating costs for the insurer and transaction costs for the insureds. Benefits are provided for members of a group, such as a credit union, who automatically receive specific insurance coverage, usually without directly paying any premiums. As there are no individual transactions, many administrative expenses are eliminated. However, organizations need to find another revenue source, such as lowering the interest rate on savings, to pay for coverage. As a result, this strategy may make the savings product uncompetitive and cause client desertion... or it could be marketed as an attractive benefit to increasing savings balances (i.e. greater the balance, the greater the benefits).

Since low-income households often cannot pay lump sum premiums, insurers work to spread out premium payments through the year – scheduling payments to coincide with the household's cash flow. This method raises transaction costs for the insurers and subsequently the premiums. To cut transaction costs, microinsurers use **low-cost premium collection methods**, such as integrating the premium into another financial transaction.

Commercial insurers often struggle to reach the low-income market because they lack an appropriate distribution system. To provide insurance through **inexpensive distribution systems**, insurers may partner with community organizations that already have distribution systems in place. For this partnership to be successful, insurance must somehow reinforce the core business of the intermediary, otherwise field staff will not give it sufficient attention. For example, when partnering with microfinance institutions, standalone

insurance is much less successful than when coverage is linked to savings or loans. Another potential inexpensive distribution system could be through mobile phones, although the experiences of using this mode to sell and service microinsurance remain in their infancy.

A key strategy for **controlling costs** is to enhance efficiency by differentiating requirements depending on the size of the insurance policy. Hence, smaller policyholders will undergo less arduous examinations and meet with less specialized (and less expensive) insurance employees. In addition, with proper oversight, healthcare providers (who work with microinsurance organizations) can lower expenses without adversely affecting quality. Clear treatment protocols can reduce costs while improving the quality of healthcare and service. Finally, investment in loss prevention can reap great returns from lower claims, while at the same time providing tangible benefits to policyholders who do not claim.

Another way to keep claims costs down is for the microinsurer to negotiate with the benefit provider – **buying benefits in bulk** will give clients benefits at a more affordable price. This method is only appropriate when benefits are provided in kind, such as a funeral parlour or health care provider, and relies on there being excess capacity, which may not always be the case.

Diversify income sources

Even when costs are minimized and benefits are small, some low-income clients still cannot afford insurance. To enhance affordability and achieve sustainability, some microinsurers diversify their income sources.

One way to diversify revenue streams is through **cross-subsidizing the premiums** from more profitable products or market segments. For example, some microinsurers serve middle-income groups, and use the returns from these more profitable segments to cover losses at the lower end of the market. However, this approach will not work very effectively in competitive environments. Organizations that try to use sliding-scale premiums have difficulty distinguishing between those who can and cannot pay premiums. Furthermore, a microinsurer may not have the correct image to attract higher-income clients or if successful, may gradually eliminate their less profitable, low-income programmes.

Another source of compensating revenue could be an **endowment or capital fund** from which investment earnings could contribute to operating costs. A capital fund can provide financial flexibility and stable funding for microinsurance schemes. Insurers need to be vigilant that their endowments generate earnings and are not diverted to other uses. Also, one needs to ensure that endowments can adequately support growth in the covered population and keep up with the rates of inflation.

Microinsurance schemes that emerge from the social protection perspective may be financed in whole or in part by **government funds**, and a strategy for sustainability is to gain access to these subsidies. A disadvantage to this approach is that it is vulnerable to political interference. Consequently, it may be hard to count on long-term or permanent subsidies from the government.

Good management

None of these strategies is appropriate in all circumstances, and they all have advantages and disadvantages. The challenge is to find ways of combining selected strategies in an approach that makes sense for each microinsurance scheme. Consequently, the key to sustainable microinsurance is to have good management that can patch together the right combination of strategies for their organizations. In addition, microinsurance managers must have appropriately skilled employees, realistic product pricing, a sound business plan, timely and reliable management information, and reinsurance, if required. Managers need tools to allow them to assess their options for expanding benefits, enhancing protection, and so on.

To manage it effectively, microinsurance should be an independent activity – separate from credit and savings and from conventional insurance. This will enable management to assess its viability and deploy expertise to allow it to achieve its potential. This expertise does not have to be in-house, as long as there is access to it. Partnerships between organizations with different types of expertise can be effective if designed to be mutually beneficial.

Although expertise is important, large volumes of policyholders are also critical. If microinsurers want to attract and keep customers, they need to have effective sales and service functions, and a good reputation for customer service.

The International Labour Organization (ILO) and the Munich Re Foundation recently published **Protecting the Poor: A Microinsurance Compendium** on behalf of the CGAP Working Group for Microinsurance. This authoritative book analyzes the experiences of more than 40 microinsurance providers and is based on the **Good and Bad Case Practices in Microinsurance** project led by the Operation Subgroup and funded by DFID, GTZ, the ILO and SIDA. The translations into French and Spanish are financed by ADA.

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