

# Insuring the Poor: The emergence of market-based insurance alternatives to the welfare state for the global poor

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## Introduction

In the developing world, low-income households have been historically vulnerable to unexpected economic shocks.<sup>1</sup> Until the past decade there were not many options to cope with the financial burden associated to risks such as illness, accidents and death. People either relied on inefficient informal arrangements<sup>2</sup> or they depended on even less efficient state-run programs. In this paper I will expose how increased mobile penetration and innovative business models have created a new market-based approach that bridge the gap between traditional insurers and low-income households. I will share some of the most relevant cases and their impact in the life of poor people all over the world. Finally, I will explain why these recent events are relevant to the ongoing cause of advancing individual liberty.

## The Problem

Illnesses, accidents and the death of a relative are by themselves undesired experiences for any person. That being said, for most people living in industrialized countries these events have become less harmful for the long-term prosperity of their households<sup>3</sup>. Thanks to the development of private insurance and the proliferation of state-sponsored safety nets the odds that a single event drives a family living in an industrialized country into poverty have been reduced dramatically<sup>4</sup>. This is not the case for the global poor, in most developing countries such an event could end up in dramatic and long-term consequences for entire families.<sup>5</sup>

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<sup>1</sup> Churchill 2006: 1.

<sup>2</sup> Churchill 2006: 30.

<sup>3</sup> Deaton 213: 23.

<sup>4</sup> Manes, 1942: 30-48.

<sup>5</sup> Churchill 2006: 42.

Take for example the death of a working member inside a poor household in Guatemala. A basic burial arrangement can cost up to twice the monthly income of the head of family.<sup>6</sup> Moreover, if there is any medical bill still to be paid the amount can increase significantly. Since households at this level live precariously, the odds of having any savings to cope with this emergency are scarce. Instead they usually have to lend money from local loan-sharks at high interest rates<sup>78</sup>. Additionally, the chances of these families staying in poverty or, even worse, descending into extreme poverty increase. Similar problems are experienced with health, crops or business related risks. Far from being an isolated local problem, this is a recurrent trend all over the developing world.

### **Traditional Solutions**

The problems that poor households in the developing world face when confronting the financial burden of such casualties have been dealt in two main forms: informal risk-sharing arrangements and state-run programs. The former can take the form of fraternal solidarity among members of a family or a close-knit community such as a church<sup>910</sup>. Although relatively effective in some cases, these arrangements lack both the serious actuarial calculation and the sustainability element that a profit based program have. Also, being based mainly on trust these schemes have serious problems that scale up and create the critical mass to sustain a long-term resilient solution. Moreover, being based around homogenous and proximate groups these arrangements usually are not able to overcome a collective event that involve many people from the same community.

Another option for low-income households is to rely on state-run programs designed as basic safety nets<sup>11</sup>. In theory, the capacity of the state to impose a compulsory social insurance would solve the kind of problem presented above in this paper. In practice, in most developing

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<sup>6</sup> Author's field research; Guatemalan minimum income for 2016 is close to US\$350, and average real income rounded the US\$275, while the cost of a regular funeral service at a local funeral house ranges between US\$370 to US\$500. This amount does not include any bills left to be paid or other related expenses.

<sup>7</sup> Churchill 2006: 33, Box 6.

<sup>8</sup> Idem; It's not rare to see monthly rates close to 30%.

<sup>9</sup> Churchill 2006: 32, Table 3.

<sup>10</sup> Idem, 35.

<sup>11</sup> Churchill 2006, 47.

countries these programs are plagued with internal problems such as systemic corruption, ineptitude in provision, and exaggerated costs due to lack of economic calculation. Very often the quality of the services provided by the state is insufficient<sup>12</sup>. When provided, the services are so deficient that many people, if possible, prefer to opt-out them. In the long term, a debt to a private clinic is better than getting some infectious bacteria in a public hospital.

A far more effective solution for this kind of problems would be provided by insurance companies. They both join the critical mass to make risk-pooling viable, and they are driven by profitability. The latter means that they should provide good quality for their customers (attract demand) and be judicious about their costs (reduce costs). Nevertheless, for the same reason, traditional insurance companies have remained (until very recently) out of the low-income market. Even if the actuarial calculation allows for the creation of insurance plans for this market, there is a bigger obstacle: transaction costs.

### **Transaction Costs in Insurance Distribution**

Apart from the pure cost of risk bearing, the other significant costs of an insurance product is the cost of its distribution to the final consumer. In the traditional model of insurance selling, that involves agents or brokers earning a variable commission depending on the amount of the sum assured, there is a natural limit that hinders the emergence of insurance product for poor people. First, the system creates the incentive for agents to pursue the higher end of the market where for similar efforts they could get higher revenues given the amounts they would be selling. But even if there are agents interested in pursuing the lower income market, the cost of a premium collection system (reminders, payment administration, collection fees, etc.) would make the product less attractive in price, and even forbidden for that market. These conditionals set a natural starting point for the minimum sum assured that is viable to sell in order to remain profitable. Since the sum that low-income households both need and can afford is significantly less than this natural limit, insurance companies have remained largely

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<sup>12</sup> Churchill 2006, 50.

outside this market<sup>13</sup>. Sometimes the high transaction costs can be avoided by collective negotiations and premium collections (e.g. a company negotiating life insurance policies for their employees or a union getting health insurance for their members). Nevertheless, in order to unleash the full potential of this financial instrument the transaction cost of each policy allocation has to diminish drastically. The turning point to this problem came with the exponential growth of digital technologies and telecommunication coverage in developing countries.

### **The Mobile Revolution**

For the past two decades there has been an ongoing mobile revolution that has changed the way we work, learn, travel and even experience the world. This revolution is usually associated with apps addressing the needs of citizens living in wealthy societies, but parallel to this there has been a bigger revolution (in user numbers) in the developing world. Hundreds of millions of people have gotten access to a mobile phone. Even if the vast majority of them still have no access to internet in their phones, the mere fact of possessing one opens the possibilities for multiple innovations. One of the outcomes that has arisen from this revolution in the developing world is the lowering of transaction costs for financial services directed to low-income households.

Services that previously took a large human resource for sales and distribution now can be channeled via mobile phone at a diminutive fraction of what it used to be. This has opened the door to radical innovations in the insurance industry. For example, while in many developing countries the amount of people with access to a mobile is well above eighty percent (80%) any kind of insurance penetration rarely goes beyond three percent (3%). In the following section I will explain what mobile micro insurance is and the growth that it has experimented in the past years.

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<sup>13</sup> A product that traditional insurance companies have offered to this market is “credit life insurance” which is a product designed to pay off a borrower's debt if that borrower dies. Often this product is acquired by and for the benefit of the lender, rather than the family of the deceased.

### **Mobile Micro insurance**

Micro insurance in general has been defined as a mechanism to protect low-income households against risks, such as illness, a death in the family, and even crop failure. In other words, micro insurance is a policy with very low coverage, compared to traditional products, with a very low monthly premium. Both characteristics make the product affordable for low-income households.

The idea has been around for many years and it had its origins as a complementary product to micro-credits. Posed with the transaction cost challenge in a previous section it took a while until a sustainable and viable model was discovered. It was accomplished thanks to the lowering of transactions costs made possible with increased mobile penetration in the developing world. It has been during the past ten years when specialized providers have devised a model that effectively leverages on the mobile penetration to distribute insurance among low-income households.

These providers employ the user base of Mobile Network Operators (MNO) as starting point to distribute insurance. Although the main products available are life and health related, there are also crop, weather, accident and cattle products available. The distribution has taken three main forms: a) Free Product, the user receives the service as a gift from the MNO and usually the coverage is proportional to the user's airtime consumption. This is often used as a strategy to increase brand loyalty and average return per user. This is an introductory product, especially for those markets with no insurance culture. b) Freemium, the user receives a basic coverage but it can increase the amount insured by paying an extra amount. This is a bridge product designed to increase user awareness of the importance of insuring themselves. c) Direct Selling, the user pays directly for the coverage he considers necessary. This one is a product targeted for developed markets with understanding of the relevance of being insured. As individual insurance markets mature the strategy of the providers shift from the first to the latter.

One important aspect to mention is that this for-profit and market-based model has managed to find a sustainable solution to the problem posed to financially vulnerable low-income households. Moreover, according to the Global System of Mobile Communication (GSM)

Association report on *Mobile Financial Services for the Unbanked*, this model has reached the scaling stage covering more than 17 million users by mid-2014 and sustaining an annual growth rate above 260%. In other words, a whole global industry has arisen in the past 10 years with the specific aim to privately insure the poor in developing countries.

In Latin-America “The movement from agents and brokers to more diverse distribution has resulted in reduced expense ratios for insurers; the weighted average expense ratio for agents and brokers is about 76% while that for the other distribution types it is between 30% and 40%. Though still behind other regions in terms of mobile linkages, LAC stands to make important strides over the next years with 10% of insurers using cell phone technology in some way, 25% planning to partner with an MNO and 50% ‘interested but with no concrete plans’.” This is an example of how the shift from the traditional model is happening even in Latin-America a region that has been very traditional in its insurance distribution.<sup>14</sup>

### **Bima Mobile, an exponential case**

Among the most successful players in this new industry Bima Mobile, headquartered in Sweden, is one of the most prominent. Bima defines itself as a “leading insurance tech player that uses mobile technology to disrupt the global insurance industry and fuel financial inclusion”<sup>15</sup>. All of their products are registered and paid using mobile technology. They have specialized in creating mutually beneficial partnerships between MNO, insurers and other financial institutions, in doing so they have managed to create affordable insurance products that serve millions of low-income families around the world.<sup>16</sup> Their mobile strategy helped them reach 24 million customers from fifteen different countries in three continents in just six years<sup>17</sup><sup>18</sup>. As 2016, it had a monthly increase of five hundred thousand users per month<sup>19</sup>.

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<sup>14</sup> MicroInsurance Centre (2015)

<sup>15</sup> As seen in “Bima Mobile: About Us” retrieved from <http://www.bimamobile.com/about-bima/about-us-new/> (11/23/2016).

<sup>16</sup> Idem

<sup>17</sup> Idem

<sup>18</sup> Ghana, Tanzania, Senegal, Uganda, Cambodia, Bangladesh, Pakistan, Indonesia, Sri Lanka, the Philippines, Fiji, Haiti, Papua New Guinea, Honduras and Paraguay

<sup>19</sup> As seen in “Bima Mobile: About Us” retrieved from <http://www.bimamobile.com/about-bima/about-us-new/> (11/23/2016).

This exponential growth has attracted more than 60 million dollars in equity funding<sup>20</sup>. Investors seem to be interested given the potential market of up to two billion potential customers around the world. Although one of the most successful, Bima is far from being the only player in the industry. In 2016 the Microinsurance Network, an organization that keeps track of the industry, has at least 90 institutional members<sup>22</sup>, many of whom are leveraging on technology to grow their customer base.

### **Low premiums, high impact**

A question raised often when exposing this new approach is the actual impact that the plans available can have in the life of those insured by this model, particularly given the small amount that is covered by the policy. Yet, even if the coverage is low, it can have a high impact on the families insured. The availability of monetary resources to face the financial burden of an unexpected death or illness already reduces the incidence in debt. Risk pricing in products designed for small businesses (crop, cattle, weather, etc.) also brings useful information for their economic calculation. Moreover, micro insurance offers protection to the working capital of small entrepreneurs, capital that otherwise would be sold to pay bills. Finally, studies in Pakistan<sup>23</sup> have found that the incidence in child labor of those families with insurance coverage is less than those without.

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<sup>20</sup> As seen in “Mobile Microinsurance leader BIMA raises US\$38.4 Million in Series C Fundraising” retrieved from <http://www.bimamobile.com/news-and-media/news/bima-secures-us38-4-million-investment> (11/23/2016).

<sup>21</sup> As seen in “Bima Mobile: Overview” retrieved from <https://www.crunchbase.com/organization/bima#/entity> (11/23/2016).

<sup>22</sup> As seen in “Microinsurance Network” retrieved from [http://www.microinsurancenet.org/members?display\\_name=&country=All&region=All&expertise=All&type\\_of\\_organisation=All&type=Organization](http://www.microinsurancenet.org/members?display_name=&country=All&region=All&expertise=All&type_of_organisation=All&type=Organization) (11/23/2016)

<sup>23</sup> Landmann 2013: 16.

## **Why is this relevant for advancing liberty?**

### **Freedom and Responsibility Culture**

The development of micro-insurance products is quite important given the dependency<sup>24</sup> and loyalty that public aid recipients develop for the state.<sup>25</sup> Offering an affordable and accessible product that help low-income families to cope with their financial vulnerabilities might be the turning point for state-run programs that far from helping the poor have become the focus of corruption and ineptitude. Moreover, the increased affordability of insurance and other financial products (savings, credit, etc.) can help the users to become acquainted with the role they can have in their own personal and financial development. Finally, the micro insurance revolution that is taking place in the developing world can serve as a rich field for further research and even the topic of a doctoral dissertation.

### **Counterexample to the Welfare State**

The development of the mobile micro insurance model is highly relevant for those interested in advancing individual liberty. It effectively offers a concrete example of a market-based solution to counteract the influence of the welfare state in developing countries. The developments of micro-insurance and its efficiency can be used as key points in debate where the role of market-based solutions to social problems is questioned.

### **Collaboration across the political spectrum**

Finally, it is worth mention that most of the information presented in this paper was found in reports and working papers prepared by the *Micro Insurance Innovation Facility* housed at the *International Labour Organization* in Geneva, many times with the help of private

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<sup>24</sup> "the welfare state's growth can be viewed as the transfer of the "dependency" function from families to state employees" as seen in Carson, Allain "What has Government Done to Our Families?" part of the Mises Daily Articles (retrieved the 23rd of November of 2016 at <https://mises.org/library/what-has-government-done-our-families>)

<sup>25</sup> In a field research on funeral coverage in low-income households conducted by the author in 2014 in the central market of Guatemala City, the totality of those interviewed (5) who had received help from the Social Security expressed feelings of "gratitude" to the "government" for coming to help them in a moment of need. A lady even remembers a bag with "coffee, sugar and bread" that was given to her as part of the burial arrangements of her late father.



foundations. A common trend in their works is the interest to develop market-based and financially sustainable solutions that help to mitigate the vulnerability of the working poor around the world. This is a goal classical liberals can certainly partake. Moreover, we can bring interesting insights to the evolving conversation around the effective provision of social security that has been taking place in recent years.

### **Conclusions**

In this paper we have briefly explored the emergence of a new mobile micro insurance industry that effectively address the financial vulnerability of low-income households in developing countries. We have analyzed how this model became possible given the radical increased mobile penetration seen over the past two decades. Also, we noted how this is financially sustainable, for profit, and a market-based solution to a problem traditionally addressed in less effective ways. Finally, we explored the importance of this model for it is a concrete example of how to privately address what up until now has been considered the feud of the welfare state.

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