

Microinsurance: the next frontier in microfinance

Microcredit has changed, and continues to change, the lives of millions of low-income people. Access to microloans enables people and entire communities to accumulate assets and raise household income and welfare. However, life savings can be simply wiped out in the event of a family member's illness or death, a house fire, or other catastrophe. Moreover, poorer people are often afraid to take worthwhile risks (such as starting a business) because they and their families have no safety net to fall back on. This hampers their ability to act, to get out of poverty, and it limits the development of a broader economy.

Over the past few years, we have witnessed a new development in the microfinance market: microinsurance. Often referred to as *the crucial next frontier* in the development of microfinance, the microinsurance market is reaching scale. The establishment of LeapFrog Financial Inclusion Fund proves this.

LeapFrog is the first global private equity fund specialized in microinsurance. Its focus is on emerging markets. The Fund was launched in September 2008 in the finale Special Session of the Clinton Global Initiative annual meeting by former President Bill Clinton, alongside Tony Blair and several heads of state. The first closing of the Fund, with an already-defined group of eligible institutional and individual investors, is expected at the end of April 2009, and the capital will be invested in microinsurance and inclusive financial services companies, giving them the opportunity to grow and succeed.

LeapFrog's President and Founder, Dr. Andrew Kuper, emphasizes the immense potential in microinsurance investments: *"We are proud of being the world's first microinsurance-focused fund. But we hope for competition in the long-term – for a hundred LeapFrogs to spring up. In seeking to demonstrate the profitability and impact of this asset class to multiple investors at such scale, LeapFrog could help blow wide open the doors of private capital for funds and enterprises built on financial inclusion. The result would be levels of investment sufficient to reach those one billion low-income people who need and demand insurance and other inclusive financial services. Everybody, from wealthy investors to poor families in Asia and Africa, could benefit from*

this profit-with-purpose industry."

The Market: one Billion People
Equity funding for the microinsurance segment is scarce and LeapFrog is the pioneer investment fund in this space, focused on meeting the insurance needs of low-income people in developing countries. But what exactly are these needs?

Microinsurance provides families with the safety and security necessary to escape poverty and increase income. For example, if a breadwinner dies, not only must funeral expenses be paid, but continued cash for basic needs and education of the family is required. A poor person's property may be limited to a few animals or crops and a modest shelter, but the destruction of any of these may be a great blow to the family's economy, even leaving people destitute. These examples are excerpts from *'The Landscape of Microinsurance in the World's 100 Poorest Countries'*, a comprehensive market analysis of microinsurance published in 2007 by The Microinsurance Centre. According to the report, the highest demand from poor people is for life and health products, followed by property insurance and accidental death and disability cover.

However, the vast majority of people in the world's poorest countries do not have access to insurance. The market is significantly underserved, with less

than three percent penetration. The estimated size of the untapped microinsurance market is between 600 million and one billion people.

By investing in insurance companies in emerging markets, the LeapFrog Financial Inclusion Fund can play a crucial role in providing access to insurance products for poor people. Beyond financial capital, LeapFrog is able to provide its investee companies with expertise and support in business planning, product design, regulatory and risk management, and development of efficient high-volume distribution channels. The importance of supporting insurance companies with more than capital becomes clear when reading 'Visions of the Future of Microinsurance, and thoughts on Getting There', written by Michael J. McCord and published by USAID (as Microinsurance Note #9) in March 2008.

Overcoming Barriers

While there is a huge demand for microinsurance products, this market segment is not without its challenges. In the Microinsurance Note, Michal Matul, Research Officer of the ILO's Microinsurance Innovation Facility, states that: *"Microinsurance massification would not be possible without building insurance culture among low-income households. In most of the developing countries, low-income clients think they do not need insurance, they do not trust insurers, they do not understand fully the risk-pooling concept, and strongly believe insurance is just for the rich and that they*

do not have enough resources to pay for it. These are key market challenges, which reduce effective demand, and thus hamper the work on widespread access to microinsurance."

In the same Note, Lemmy Manje, the Mennonite Economic Development Associates (MEDA) Field Project Manager for Ethiopia and Zambia, suggests that microinsurance massification will need to focus on voluntary products and that customer satisfaction will be the key to expansion of such products: *"Microfinance institutions, usually serving as 'front offices' for microinsurance products, need increased capacity building on insurance concepts to communicate effectively to clients."* Clearly marketing is a necessity, and financial education programs are a must, to familiarize people with insurance products, so as to build trust and consequently to translate demand into effective demand.

Equally important is product development. Dr. Jim Roth, a partner in LeapFrog Investments, underlines the importance of helping commercial insurers to develop profitable products. According to Roth: *"Microinsurance can be done in a variety of ways at the macro, meso and micro levels. Commercial insurers have proved to be one of the most successful means of scaling up microinsurance. If we want the commercial sector to expand in this space, then the crucial question for our product development endeavors is 'will whatever we are doing help commercial insurers*

develop profitable products?"

Impact of the global financial crisis

Past experience has shown that private equity funds that start in recession tend to do quite well. They buy assets at depressed prices and sell them when the recession has passed. LeapFrog aims to be no exception. At the client level, some low-income people may have less discretionary income or hold on to it tighter in these uncertain times, but on the other hand people with assets and with less income to replace these assets might become more concerned to avoid loss. So the demand for microinsurance products may increase. In any case, given a market of up to a billion people that is only 3% penetrated, the burgeoning microinsurance sector is well-positioned to endure financial storms and moreover offer non-market-tracking returns.

By seeking strong financial returns but also distinctive social returns – providing ways for millions of poor people to better manage their risks – LeapFrog represents a form of capitalism that is both creative and protective. Few breakthroughs are more important to the future of finance and emerging markets.



Employee of investee company