

Risk it or **insure** it?

Understanding the microinsurance purchase decision • March 2009

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This document is focus note 8 in a series of 12 produced as part of a five country study on the role of policy, regulation and supervision in making microinsurance work for the poor. See page 7 for further details.

1 Introduction

Access to insurance may be an important strategy for reducing poverty. Financial markets, and particularly insurance services, can help poor people manage critical risks such as death in the family, illness, or loss of income or property. Despite the growing importance and expansion of microinsurance services geared to low-income people, microinsurance penetration remains limited, leaving the vast majority of poor people without adequate protection.

This focus note explores the factors that influence people in deciding to buy insurance to manage their risks. The analysis draws on evidence from five country studies on the development of microinsurance markets, specifically considering the impact of regulation: Colombia, India, the Philippines, South Africa and Uganda. The individual country reports and summary findings can be accessed at www.cenfri.org.

Note on scope. The five country studies did not investigate health insurance. However, many of the factors identified by the research may apply in the health field.

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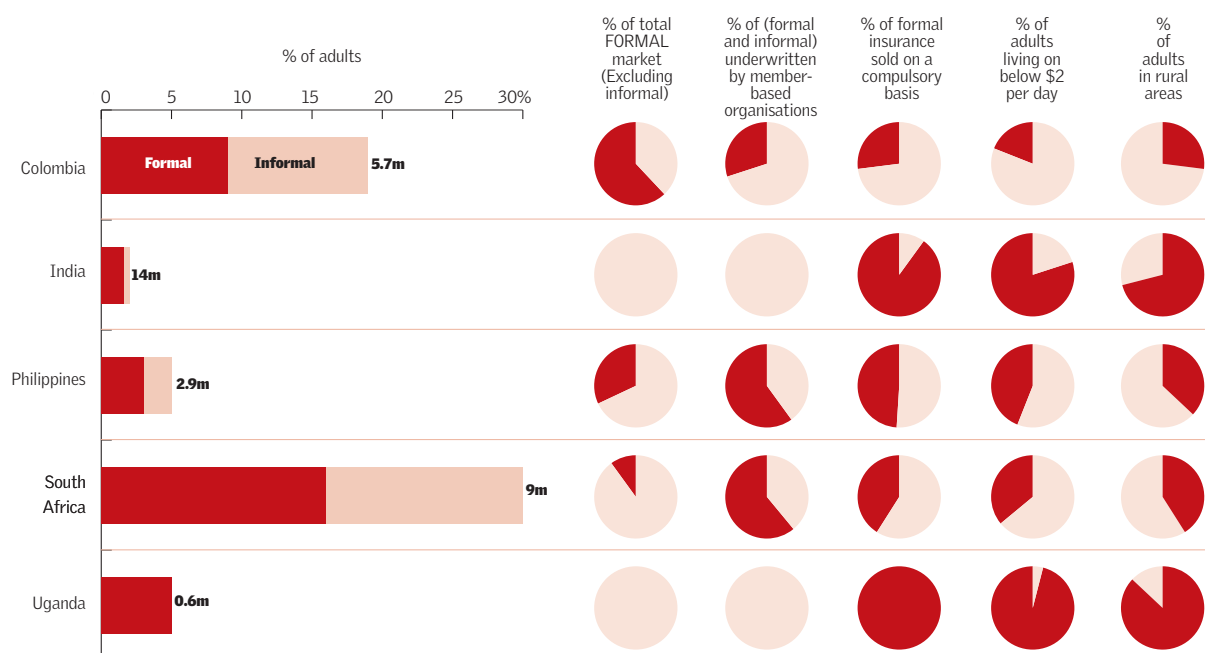


Figure 1: Microinsurance market features in the five countries

Note that, for India, there may be some informal schemes not picked up in the analysis. Government-subsidised schemes, which are quite large in India, were also excluded from the analysis.

2 Cross-country usage features

The uptake of insurance products varies across countries and insurance products, but some common trends are apparent, as captured in Figure 1:

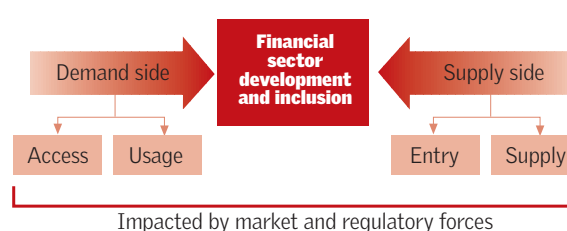
Microinsurance consists mostly of compulsory credit life on the back of credit, while member-based insurers (where they exist) seem to have more success in selling microinsurance than their commercial counterparts, particularly in informal markets¹. Of all voluntary insurance products, funeral insurance is the most popular, accounting for 72% of the microinsurance market in South Africa and at least 52% in Colombia (the two countries where a breakdown by product was possible). Superficially, this could be ascribed to "culture", but the fact that funeral insurance leads the market in a range of countries suggests that other factors are at work. What does varying success of product categories, and the risk management behaviour of poor people, tell us about why they buy insurance?

3 Access to insurance may not be sufficient to trigger the usage decision

The financial inclusion framework.

Growing microinsurance markets meets the broader policy objective of extending financial inclusion, which entails giving consumers of all incomes access to, and sustainable use of, appropriate and affordable financial services.

Among the factors that determine the level of inclusion are those that affect consumers directly (demand-side factors) and that affect service providers (supply-side factors). On the demand-side, these may present access barriers, which exclude people from using a service, or usage barriers, which may discourage potential users without explicitly barring



¹ See Focus note 9 on the role and regulation of member-based insurers.

Figure 2: Financial inclusion framework

Source: Da Silva and Chamberlain, 2008

them. In the same way, financial service providers may face entry barriers, which prevent them from providing a service to the lower-income market, or supply barriers, which act as a deterrent. Figure 2 shows this schematically.

The demand-side factors of access and usage are central to the discussion of the insurance decision:

- **Access barriers** make it impossible for a person to use a particular financial service. FinMark Trust² identifies five such factors: physical proximity, affordability, eligibility, appropriate product features or terms, and regulation.
- **Usage barriers** do not raise an absolute barrier, but discourage individuals from taking up formal financial services. In deciding whether to buy a product, consumers make a complex assessment of its value and ability to meet their needs, based on their knowledge and experience. Factors that may influence them include the value proposition (for example, the perception that paying insurance premiums without necessarily being able to claim involves “throwing money in the water”); relative cost (compared to informal alternatives, for example); the “hassle factor”, such as having to complete forms; and adverse perceptions of formal products and institution, including the fear of officialdom and belief that financial institutions are for the rich.

The role of the insurance decision in determining usage. Those seeking greater inclusion have traditionally emphasised access barriers to insurance, but there is a growing realisation that removing such barriers does not necessarily mean higher uptake. Supply-side interventions aimed at putting affordable and suitable products within easy reach of low-income consumers will not necessarily suffice – the decision to buy insurance must be triggered.

To do this, demand-side factors such as behaviour, perceptions, knowledge and trust must be understood. What behavioural and other usage factors shape the decision to buy insurance?

4 The consumer’s view of the insurance value proposition

The five country case studies provide insights into the insurance decision. In these, low-income market focus groups were asked to discuss their risk experiences and perceptions and understanding of insurance, typically without being told in advance that insurance was under discussion. This allowed people from similar backgrounds to interact and share views. The research highlighted the following cross-cutting demand-side insights³ into microinsurance markets:

The poor face many material risks. In all the focus groups poor people were aware of their risk exposure, particularly to ill-health. The risk of a breadwinner dying, or becoming disabled or unemployed, was often cited. The risk of assets being lost or damaged, while considered important, was seen as a lower priority.

- In **Colombia**, the death of a breadwinner was seen as the most important risk, coupled with the need to cover funeral expenses. This was followed by accidents, illness, hospitalisation, disability and natural disasters.
- The risk of death, unemployment or illness was stressed in **South Africa**.
- Health was the top priority for more than 60% of participants in the **Indian** focus groups.
- Respondents in the **Philippines** indicated that illness in the family was the only eventuality for which they needed risk mitigation.
- “Well, it is sickness, because you are not sure and it is your life. You can forego a wedding but you cannot forego sickness. You have to attend to it immediately.” (**Ugandan** respondent)

Low knowledge and awareness of the insurance value proposition. Some respondents indicated that they are familiar with insurance as a form of protection that gives one “peace of mind”, but there was general uncertainty about how it works. In the Philippines, some respondents said insurance had never been introduced or explained to them, and that for this reason they had not considered buying an

² For more information see Chamberlain, D., 2005. Measuring Access to Transaction Banking Services in the Southern African Customs Union – an Index Approach. Genesis Analytics project for the FinMark Trust.

³ All such insights are to be regarded as qualitative only and are not statistically representative of the low-income population.

insurance product. Several of the focus groups objected that money had to be paid in premiums, but that they could not claim unless the risk event occurred. This underscores a misunderstanding of the insurance value proposition – insurance is often perceived as being a savings vehicle with guaranteed returns, whereas in fact it offers protection against possible misfortune. The following responses from the Ugandan focus groups underline limited knowledge and awareness:

- “There is one reason why I would not go for insurance, even if it is charging me one shilling, you say you have insured me for let us say burglar [and] no burglar comes even close to my house to take anything. At the end of the year I would have given the insurance company free money.”
- “Sincerely this community knows nothing about insurance. Most of the insurance companies are based in the city. Those that we know, we see adverts as we go to Kampala.”
- “I don’t trust insurance companies because I cannot trust something I don’t have full knowledge about. I need to be educated fully about it and therefore I can decide whether to trust it or not.”

Trust is critical to insurance uptake: Introducing people to insurance works better when they trust the provider or intermediary. Community or member-based groups are more likely to generate trust, as are well-known brands (such as retailers, utility companies or banks) and positive claims experiences conveyed by word of mouth. Trust is also determined by people’s belief that they can make legitimate claims on the policy. Consumers may not fully understand long and complicated policy documents, and may suspect that they conceal many pretexts for insurers to reject claims.

The focus groups revealed widespread mistrust of insurance, and of formal insurers in particular:

- Among *Indian* respondents, mistrust and perceptions of low benefits ranked second only to a lack of awareness and affordability among reasons for not buying insurance.
- “I do not trust them. They are profit-making companies. They do not benefit people,” (*Ugandan* respondent).
- Many respondents in the *Philippines* said that they do not want to purchase insurance products because of negative experiences with a big com-

mercial insurance provider and some pre-need companies which defaulted on their commitments. This has damaged the insurance industry’s reputation in the low-income market.

- This was echoed in *Uganda*, where hyperinflation eroded the value of life insurance policies two decades ago. Said one respondent: “Previously insurance was okay. Government used to honour claims, but eventually they failed and people completely lost the idea of insurance.”

The importance of quick and reliable claims payments: Claims payment emerged as an important factor in people’s perceptions, and trust, of insurance. A negative claims experience, or hearing about the negative claims experiences of others, may lead to hostile perceptions of insurance. Speedy payments with little administrative hassle are vital.

- “They take long to compensate their customers when risks occur. That is what I have heard, but I don’t know whether it is true.” (*Ugandan* respondent)
- “I have seen the bad experience my grandmother had with her cellphone insurance. When it was faulty, they kept on fixing it without replacing the phone ... It cost us transport money to take it in. From there on, I hate everything and anything about cellphone insurance, as they will not replace the cellphone. The process was tedious and annoying. Moreover, in the meantime you suffer, as you have no other phone to use and you are paying.” (*South African* respondent)

A similar picture emerged outside the focus groups. In the Philippines, long delays in claims payments were the main factor in CARD MBA’s decision to obtain its own insurance license. Also, most complaints received by the Ugandan Insurance Commission relate to delays in the settlement of claims.

- Affordability and spending priorities:* Even when respondents acknowledge that insurance could offer value, affordability is a problem, given other spending priorities. This is especially true of participants with irregular incomes or who cannot commit themselves to a fixed monthly premium. This may be a perceptual problem, however, as respondents did not always know the cost of insurance.
- Among respondents in *India*, affordability ranked second only to lack of awareness as a

reason for not taking up insurance. But even if affordable products were available, respondents tended to perceive insurance as unaffordable

- In *Colombia*, some focus group participants said that they do not have insurance because they consider it expensive and believe only high-income people can afford it.
- In the *Philippines*, respondents spend between 50% and 70% of their income on food and educating children, leaving little room for insurance.
- "It is very expensive to afford; it is usually big organisations and the rich." (*Ugandan* respondent)

Price-sensitivity may vary, depending on the product category. A surprising insight gleaned from the *South African* focus group discussions was the relative insensitivity towards the price of funeral insurance, with one respondent being unconcerned that another group member pays far less for the same cover. This, however, did not apply to asset insurance.

- "... a cellphone insurance may cost R35. If I have R50, I cannot spare R35 to pay insurance because I need to use the same money to pay transport to go and pay the insurance. As it stands now, I do not have a bank account where insurance money can be debited." (South African respondent)

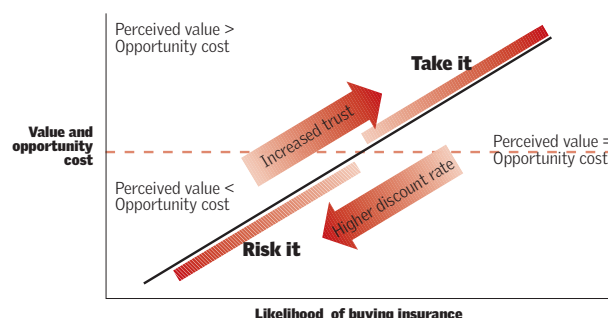
The focus group research indicates that although affordability is perceived as a significant barrier to access, trust and low levels of knowledge and awareness are the main factors in low demand for insurance –despite high levels of need. Demand-side factors, rather than supply problems, often inhibit the uptake of insurance.

5 Towards a model of the insurance decision

Analysing the trends in insurance usage and the demand-side experiences in the sample countries, certain patterns emerge. In this section, we combine these in a behavioural model that may help to explain why people buy, or avoid buying, insurance. The model can be represented as follows:

Figure 3: Model of the insurance decision

Source: Chamberlain, 2008



Unless they have no choice, people buy insurance only if they have money for it and its perceived value exceeds the *perceived* opportunity cost. "Perceived" is the operative word, as consumers do not always fully understand the cost or the benefit.

If the perceived cost exceeds the perceived value, the consumer will avoid buying the product and accept the relevant risk. Various factors shape perceptions of the cost and value:

Perceived cost is determined by the size of the premium and the opportunity cost of paying it. A poor consumer whose income is entirely devoted to buying necessities may have to give up other goods or services to pay for insurance. As a result, the perceived cost will exceed the actual cost of the premium, as the opportunity cost of forgoing other consumption is also factored in.

From the country evidence, *perceived value* seems to be influenced by at least four factors:

- *Over-discounting*: The discount rate is the implicit interest rate at which a person reduces the value of a future benefit to a present value. It is argued⁴ that low-income households place a disproportionately high value on current consumption relative to deferred consumption of a future benefit – in other words, they over-discount. This suggests that they find it hard to calculate the value of future benefits, but also underscores the opportunity cost of postponing consumption, particularly when available

4 Behavioural economics challenges neo-classical theories such as the life-cycle hypothesis and the permanent income hypothesis by posing a hyperbolic discounting theory that argues that people over-discount future needs in favour of current consumption. That is, people tend to prioritise current consumption, implying a disinclination to save for long-term goals where current needs are pressing, or to insure for uncertain risks. See for example Deaton, 2005.

resources barely covers necessities.

- **Tangible benefits:** The investigation of the insurance market presented in this study suggests that over-discounting may be exacerbated when future benefits take the form of a cash payout rather than tangible benefits such as a funeral service or new mobile phone. Poor clients seem more likely to choose a microinsurance product which promises a tangible benefit, rather than one which promises a cash payment only. One reason for this may be that the value of a tangible benefit is easier to assess and does not need to be discounted. Funeral insurance in South Africa and Colombia are cases in point. Not only is the benefit tangible – a funeral service – but clients often buy policies from funeral parlours. Clients tend to visit parlours to buy funeral services, rather than insurance, and often do not understand the insurance mechanism used to fund this. Microinsurance products in Colombia are another example. Offering life or disability cover with a cash payout, they incorporate grocery coupons, a monthly fee covering a year's educational expenses for all children in the family under the age 18, and a funeral service.
- **Levels of trust.** The perceived value of an insurance product is enhanced when consumers feel greater trust in their ability to lodge successful claims. Several factors influence the level of trust. A complex product with a lengthy contract document containing much fine print, rather than a simple or commoditised product with accessible terms, may lead consumers to distrust their ability to claim successfully. In the same way, insurers who pay legitimate claims promptly will enjoy greater trust, and their products will have higher perceived value. Member-owned organisations and trusted clothing retailers have also been able to win higher levels of trust. For this reason, member-owned groups often have more success in distributing microinsurance than agents or brokers whom customers do not know.
- **Probability of the risk event happening.** Products covering health and life risks, where there is a high likelihood that a need will arise, have a higher perceived value than products covering asset risks, where risk events happen infrequently or not at all.

6 Conclusion

Taken together, the above factors help explain why poor consumers choose to buy, or not to buy, insurance products. Simple products that offer tangible benefits, cover life or health risks and are sold through a trusted provider are more likely to be successful than more complex products providing cash benefits only and that cover risk events that are infrequent and may not even occur. This does not rule out the possibility of selling other insurance products. What it suggests is that these will involve a more vigorous sales effort and hence higher costs, as well as a heavier reliance on trusted channels.

More research will be required to test and refine this model.

The focus note series

Focus note 1: What is microinsurance and why does it matter? The rationale for microinsurance from a regulator's perspective.

Focus note 2: The role of policy, regulation and supervision in making insurance markets work for the poor: Executive summary and emerging guidelines;

Focus note 3: The role of policy, regulation and supervision in making insurance markets work for the poor: The experience of Colombia;

Focus note 4: The role of policy, regulation and supervision in making insurance markets work for the poor: The experience of India;

Focus note 5: The role of policy, regulation and supervision in making insurance markets work for the poor: The experience of the Philippines;

Focus note 6: The role of policy, regulation and

supervision in making insurance markets work for the poor: The experience of South Africa;

Focus note 7: The role of policy, regulation and supervision in making insurance markets work for the poor: The experience of Uganda;

Focus note 8: Risk it or insure it? Understanding the microinsurance purchase decision;

Focus note 9: Ensuring mutual benefit: The role and regulation of member-owned insurers;

Focus note 10: Informal insurance: a regulator's perspective;

Focus note 11: The impact of policy, regulation and supervision on the development of microinsurance markets; and

Focus note 12: Making a market for microinsurance: the success and failure of different channels of delivery.



About this document

To support the development of microinsurance markets, a project was launched under the auspices of the IAIS-MIN JWGM^I aimed at mapping the experience of five developing countries – Colombia, India, the Philippines, South Africa and Uganda – where microinsurance markets have evolved in varying degrees.

The objective was to assess how much regulation has affected the evolution of these markets and gain insights which can guide policy-makers, regulators and supervisors looking to support the development of microinsurance in their jurisdiction.

To disseminate the findings of this project, a number of focus notes have been written to highlight themes that emerged from it. This document is the

eighth focus note in a series of 12 – six thematic focus notes and six notes summarising each country study.

The project was majority-funded by the Canadian IDRC^{II} (www.idrc.ca) and the Bill and Melinda Gates Foundation (www.gatesfoundation.org), with funding and technical support from the South African-based FinMark Trust^{III} (www.finmarktrust.org.za) and the German GTZ^{IV} (www.gtz.de) and BMZ^V (www.bmz.de). FinMark Trust was contracted to oversee the project on behalf of the funders. With representatives of the IAIS, the ILO, the Microinsurance Centre and the International Cooperative and Mutual Insurance Federation (ICMIF), the funders are also represented on an advisory committee overseeing the study.

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- I International Association of Insurance Supervisors (IAIS) and Microinsurance Network (MIN) Joint Working Group on Microinsurance
 - II International Development Research Centre
 - III Funded by the UK Department for International Development (DFID).
 - IV Deutsche Gesellschaft für Technische Zusammenarbeit GmbH.
 - V Bundesministerium für Wirtschaftliche Zusammenarbeit und Entwicklung - Federal Ministry of Economic Cooperation and Development

These focus notes and other material related to the project can be downloaded at www.cenfri.org. For more information, please contact the project coordinator, Doubell Chamberlain: Doubell@cenfri.org



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