Operational excellence for insurers focusing on emerging consumers
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Introduction

We are pleased to present this report which explores the opportunities and challenges of selling and providing insurance to low-income customers, and shows how an organization can use an operational excellence approach to operate efficiently and, thus, sustain profitability.

The report is a collaborative effort between EY and LeapFrog Investments, a profit-with-purpose private equity fund and the world’s largest dedicated investor in insurance and related financial services to low-income consumers in Africa and Asia. LeapFrog is successfully tapping this market by investing in companies that offer financial products, and providing valuable safety nets and springboards to the next billion low-income emerging consumers.

We have incorporated our perspectives and those of LeapFrog to drill down on operational improvement activities that will play a dominant role in future investment in this emerging consumer market. We encourage you to use this report to create forums for discussion among insurance companies, intermediaries, regulators, investors and other stakeholders. Identifying the operational levers that are critical for success in these markets will ensure that business model paradigms evolve to effectively service this large and important customer segment.

Shaun Crawford  Rajiv Memani
Global Insurance Leader  Global Emerging Markets Leader
Operational excellence for insurers focusing on emerging consumers
Executive summary

The middle class has played a special role in economic thought for centuries, and has been the primary segment responsible for the growth of consumption-driven economies. In Asia alone, 525 million people can count themselves as middle class – more than the total population of the European Union. We are now seeing the rise of a large low-income segment that is predicted to become a major market influence over the next 10 to 20 years: the “emerging consumer.” Today, these consumers typically lack the basic financial services that are critical to fuel savings and investment. Greater financial inclusion will play an important role in the transformational journey from the low-income segment to the global middle class.

Beyond just a safety net, insurance is an enabler for such consumers, allowing them to take risks and invest in business opportunities without worries of losing their earnings to an unforeseen event. Insurance for such emerging consumers is growing in global importance as various entities from state-backed public sectors and mutual companies to large-scale commercial insurers focus on this market. While this business segment is often termed “microinsurance” by regulatory regimes, our broader definition of “insurance for the emerging consumer” is more aligned to the theme of this report.

With growth expected to come from emerging markets in Asia and Africa, insurers are looking to invest in these markets to achieve their growth targets. The critical challenge will be to access and service these customers in the most cost-efficient and sustainable manner while building long-term relationships. As we will discuss, the challenges in these markets are unique as local constraints affect business and operating model designs. No cookie-cutter models will work.

This market also presents a need for greater financial, operational and technical investment. A differentiated operational strategy backed by a dedicated organization, skilled manpower and robust performance management systems is critical for insurers to succeed. These pillars of the operational excellence framework are defined in this report. It is important for insurers, investors and other stakeholders to invest in building this framework in their organizations to support the business transformations required to reach emerging consumers and achieve sustainable value.
The opportunity: insurance for the emerging consumer

There is growing evidence that changing global economic trends will transform the customer base for most industries across the world. Rising per capita incomes, favorable demographics and continuing economic growth are leading to a massive expansion of the emerging middle class.

The World Bank defines the middle class in two brackets based on earnings per day: US$2-US$9 and US$9-US$13. According to the World Bank, 10 times as many people entered the lower versus the higher income bracket between 1990 and 2005 – highlighting the success of countries such as India and China that have invested millions in the middle class over the past two decades. For this report, our focus is on those earning US$2-US$9 per day, or the “emerging consumer.” We define the “global middle class” as earning an average of US$10-US$100 per day. This level of consumer has more disposable income to buy consumable goods and invest in financial and non-financial assets.

While the remarkable growth of emerging market economies has brought millions out of poverty, fewer people have moved into the global middle class. Over the next two decades, we estimate that the middle class will expand by another 3 billion people, coming almost exclusively from the current low-income segment (see Table 1).

Financial inclusion will be important to aid this expansion. The significance of insurance for this low-income customer segment cannot be overstated, particularly given the lack of social health care in these countries. Life insurance supports a family when the breadwinner dies; in-patient hospitalization costs are generally paid for through out-of-pocket expenses and can deplete existing savings. As climate change and natural disasters such as Cyclone Phailin in the Philippines become more prevalent, the importance of asset-backed insurance (e.g., for weather, cattle and livestock) continues to grow.

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1. Innovating for the next three billion, EY, 2011, p.1.
2. Hitting the sweet spot: the growth of the middle class in emerging markets, EY, 2013.
The importance of insurance

Insurance has clear social value for the emerging consumer. Low-income consumers need to be insulated from risk since they lack the accumulated capital to withstand adverse events. Apart from its advantages as a risk management tool, insurance enables low-income consumers to take calculated risks to emerge from poverty, make wise investments or assure their families will be provided for in case of an unforeseen event.

As economists Abhijit Banerjee and Esther Duflo point out in their book, Poor Economics, the poor are not irrational in their spending behavior, but rather hyper-rational, because the value of each money unit is higher than for other consumer segments. Thus, insurers should understand some of the key challenges facing these consumers and align their operating models to service them better:

- **Inconsistent cash flows** – These consumers often have irregular pay cycles, making premium payments difficult.
- **Significant dependency on a single source of income** – Dependence on one main breadwinner may create a financial burden.
- **A mobile segment** – Many jobs require long commutes from rural areas and constant mobility; lack of portability and accessibility may hinder the purchase of insurance.
- **Lack of awareness of the concept of insurance** – Risk pooling or premium payment benefits that may not accrue to the customer may be difficult concepts to understand.
- **Lack of trust** – For some industries, this may lead to reputational issues; these can be more extreme when purchasing an intangible product like insurance.

Despite these challenges, customers spend sleepless nights worrying about various risks. The vulnerability is much greater for this segment than for others with higher disposable income.

How big is this market?

In 2009, there were approximately 1.5 billion–3 billion people with minimal access to formal insurance services globally, as highlighted by Lloyd’s of London. Today’s audience has not changed significantly, but consumers face different risks – related to life, health and assets. ILO’s Microinsurance Innovation Facility believes that insurance for low-income consumers has evolved differently across geographies – from 200% growth between 2008 and 2012 in Africa to a steady evolution in India and other Asian economies.

India has the largest share of low-income consumers with insurance – the result of strong regulation and government schemes, especially in health insurance. South Africa, Kenya, Ghana and Tanzania have been rapidly increasing coverage and developing microinsurance-focused regulations. Asian economies such as Indonesia, the Philippines, Bangladesh and Pakistan continue to grow in this space as well.

Emerging markets are unique in terms of demographic and economic segmentation. Countries such as India have a more standard income-based segmentation
pyramid (as shown in Table 2), whereas other developing countries such as Ghana and Nigeria have a flatter pyramid, with most potential customers in the low-income segment.

Globally, we observe many insurers and intermediaries expanding their sales focus down the pyramid to reach the emerging consumer. Depending on the specific market, some players are servicing the low-income customer segment through simple insurance offerings and third-party distribution. Nevertheless, the vast majority are conventional insurers targeting the current “top” of the pyramid.

Irrespective of the geography, insurers recognize that today’s low-income customers are tomorrow’s middle class. However, winning this customer segment is not just about creating lower-priced products or selling existing products using a third-party distributor such as a micro-finance institution. Insurers will have to learn from the dynamics of their respective markets and drive innovation by transforming their strategies and operating models to grow with emerging consumers and their developing needs.

But is it profitable?

The foremost challenge for insurers in this market is the lack of systems and dedicated performance management tools to track profitability. These are often missing because of a lack of investment or simply lack of focus by senior management. The industry segment is young and lacks tracking tools. Insurers usually do not separate performance reporting between traditional and emerging consumer insurance. Future performance management tools need to capture metrics for both revenue and cost to determine the profitability trends for this segment.

Typically, there is a lack of historical risk data for low-income consumers. Thus, pricing is not very scientific and uses proxies with a constant iterative feedback loop. As historical data quality improves, we expect risk-based pricing for this segment will lead to better-priced products.

Insurers are leveraging various technology-enabled channels, such as mobile phones in Africa, to sell these insurance services, thereby reducing distributor and operating expenses. They are also selling life insurance through retailers reusing rechargeable vouchers, thus eliminating the distributor layer and...
trimming costs significantly. Various government-sponsored insurance schemes have standardized processes for enrollment of new beneficiaries, post-sale servicing and claims management. However, there are no universal measures to reduce market costs—an important objective since insurers need to demonstrate profitability. Those insurers who can redefine their operating models and generate high operational efficiency will reap the benefits of serving this large, untapped and developing customer segment.

**Need for greater investment**

Insurance companies in emerging markets have typically found it expensive to cater to the emerging consumer. The high cost of acquisition, lack of trust and inaccessibility make outreach difficult. Moreover, many insurers have failed to develop a sound business case, with a low-cost and differentiated operational strategy, to enter these markets.

Insurance for the emerging consumer is still in a nascent stage. While large insurers may be deploying significant capital to penetrate this market, other initiatives have been part of corporate social responsibility or philanthropic programs. Often these projects target specific concerns related to product development, distribution or customer awareness. Such forms of funding do not appear sustainable or scalable for the long term.

Transformational programs are required to achieve operational excellence. This is where investment from insurers or private equity investors (more specifically, impact investors) can bring true value—not just in the form of capital, but also technical knowledge and expertise to develop cost-efficient distribution channels and well-designed products, and to drive organizational change for profitability.

As insurers rapidly expand in emerging markets, we see opportunities to help them with specific geographic issues in impact investing, measurement and value generation. We are working together with LeapFrog Investments to reach this virtually untapped market. Their approach is a compelling complement to our broad service lines and global competence.
Effectively targeting emerging consumers

Many insurers have used existing operating models in innovative ways to reach the low-income consumer. A large private sector life insurer in India, for example, created a “top-up” life insurance product in 2008, offering low-income consumers pay-as-you-go options. This eliminated scheduled premiums for consumers that typically do not have a steady stream of income.

In addition to our earlier discussion of issues facing consumers, there are three dominant challenges for insurers to consider in developing the emerging consumer market.

- **Awareness** – Building customer trust through educational and marketing initiatives; the most convincing way for insurers to build awareness is to deliver on their claims’ promises
- **Affordability** – Providing insurance at an affordable price and benefits that the end customer values; this places high importance on product design
- **Accessibility** – Ensuring ease in purchasing insurance, servicing and claims handling

These three challenges can be mapped to the following external and internal success factors that will play an important role in developing this market.
that insurance sales, post-sale servicing and claims management are quick and efficient.

Intermediaries and partnerships
Distribution is one of the most important concerns. Last-mile connectivity with customers is a challenge due to a large segment living in inaccessible areas, their constant mobility, or simply a lack of access to the same touch points more affluent segments have (e.g., bank branches, financial advisors). Use of traditional distribution channels, such as agents or advisors, can be an expensive proposition due to high commissions and the need to adapt specific requirements for this segment. Furthermore, existing channels are typically not trained to deal with the lower-income consumer.

Along with traditional channels that are managed in a lean and cost-efficient manner, there are other successful distribution alternatives in this market that include partner-agent models (e.g., using business correspondents), as well as those created by piggybacking on existing distribution channels (e.g., mobile network operators, retailers).

Internal success factors
Low-cost and efficient operating model
Insurance for low-income consumers is a low-margin business due to lower average premiums per customer and relatively high fixed costs. This makes it more

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important to run an efficient operating model with simplicity and innovation, and ensure that internal processes are standardized across the organization. Customer interfaces need to be simplified with each customer touch point for consistent communication. The need to leverage technology to achieve these objectives is a given.

Supporting governance structure and performance management framework
Institutional and infrastructural conditions in emerging markets lead to specific requirements in running the business, such as decentralized sales or strong interaction with intermediaries. This requires robust governance and risk management structures, which support management steering and enable operational control in critical areas such as quality issues or fraud. In these situations, a well-functioning performance management framework, with operational KPIs and controls, is important to identify issues and react to deviations. This should be embedded across the organizational structure.

Simple and innovative product design
Simple yet innovative product design is critical to increase penetration in this market. Products need to be easily understood by customers, easy for agents or intermediaries to sell, and provide real value for the client. Additionally, standardized products will improve operational quality and efficiency, which is critical to running a profitable business in a low-margin segment.

In the next few years, innovative solutions that provide insurance to emerging consumers will include:
• Selling insurance through a utility company (e.g., Mapfre and Codensa in Colombia)
• Reaching small businesses for agriculture insurance via mobile phone technology (e.g., Kilimo Salama in East Africa)
• Integrated products with a telecom provider; outsourcing customer service and premium collection to intermediaries or facilitators (e.g., Bima in Asia and Africa)

Many of these solutions will be independent or integrated services. But insurance companies will drive these innovations, and only those players that are able to develop profitable operating models will succeed. While leveraging third-party providers for various services will be important, insurers still need to focus on their customer relationships and operations to generate maximum value from these third-party relationships.

Customer-centricity, operational efficiency, risk management and performance management will be crucial, but will not ensure sustainable success in this market. The most important aspects are corporate culture (change, individual involvement and leadership) and the mindset of people.
Operational excellence has its origins in markets such as the automotive industry where price and cost competition have led to greater customer-centricity, process efficiency and innovation – and to various process improvement approaches such as Six Sigma and Lean Management. These are extremely critical in low-margin businesses. Insurers have used smart cards for enrollments, paperless insurance policies and straight-through underwriting processes to streamline their operations to serve low-income customers.

Emerging markets require holistic and sustainable solutions which are customer-driven, end-to-end focused and support innovation. Operational excellence is a market-leading approach which has a perfect fit in this situation. Considering the dynamics of this market, it is critical to regularly update the operational excellence framework – i.e., processes and technology, skills and capabilities, performance management, operating model, mindset and behavior.

Operational excellence approaches were invented to implement a culture of continuous improvement. The underlying concept is that employees who face operational issues initiate regular changes and improvement steps, such as:

- Reducing work that is not adding value
- Removing obstacles and establishing best working practices
- Building skills and capabilities to create the best coverage and flexibility in the organization
- Realizing efficiency potential by operational and structural changes

These continuous activities are supported by proven analytical tools and working methods that enable measurable and significant improvement by increasing efficiency, quality and customer satisfaction.

Operational excellence: a holistic business transformation approach

Streamlining operations in India

A government backed insurance scheme in India is the world’s largest micro-health insurance program and is a public-private partnership (PPP) effort with the government and various traditional insurance companies that act as risk carriers. The scheme caters to below poverty line (BPL) families. A family floater health insurance policy provides standard inpatient hospitalization coverage worth INR 30,000 (USD 500), with an average premium of INR 500 (USD8–USD10). Typical margins for traditional insurers are 5%-6% (depending on claims ratios, payments to third-party administrators and operating expenses). While it is difficult to limit claims and TPA fees, insurers with robust operating models have reduced their operating expenses and increased their margins.

In addition to creating a culture of continuous improvement, which might take years or even a decade, the underlying ideas and working methods of the operational excellence approach can also be used for focused improvement, design or required change projects. Instead of focusing on only one dimension – e.g., improving processes – the operational excellence framework includes all major dimensions and dependencies that influence the organization’s activities.

5. EY analysis
We believe that an operational excellence approach can help insurers improve levers to achieve efficiencies and customer focus across the organization in all of these dimensions:

### Processes and technology
- Identify end-to-end process optimization across the most critical areas of new business processing, post-sale servicing and claims management
- Be flexible in changing processes – allowing multiple options for premium payment, modes of payment, etc.
- Develop lean processes or working procedures and identify areas for improvement
- Use technology solutions to create an optimized process flow – e.g., use of mobile, smart-card technology for improved processing

### Skills and capabilities
- Understand how sales capabilities for this market differ from traditional insurance
- Identify skill gaps and define ways to improve the required team skills
- Increase team flexibility by applying substitution models and working procedures
- Develop platforms for sharing best practices among teams to apply learning from regions to local practices

### Performance management
- Identify issues and define the future state of information flows, reporting/measurements, decision-making and meeting structures (transparency, motivation, quality)
- Develop governance, operational targets and KPIs, identifying issues in decentralized organizational structures

Table 7. Operational dimensions in operational excellence

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<tr>
<th>Dimension</th>
<th>Description</th>
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<td>Processes and technology</td>
<td>Identify end-to-end process optimization across the most critical areas of</td>
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<td>new business processing, post-sale servicing and claims management</td>
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<td>Be flexible in changing processes – allowing multiple options for premium</td>
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<td>payment, modes of payment, etc.</td>
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<td>Develop lean processes or working procedures and identify areas for</td>
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<td>Use technology solutions to create an optimized process flow – e.g., use of</td>
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<td>mobile, smart-card technology for improved processing</td>
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<tr>
<td>Skills and capabilities</td>
<td>Understand how sales capabilities for this market differ from traditional</td>
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<td></td>
<td>Identify skill gaps and define ways to improve the required team skills</td>
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<td>Increase team flexibility by applying substitution models and working</td>
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<td>procedures</td>
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<td></td>
<td>Develop platforms for sharing best practices among teams to apply learning</td>
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<td>from regions to local practices</td>
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<tr>
<td>Performance management</td>
<td>Identify issues and define the future state of information flows, reporting</td>
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<td>/measurements, decision-making and meeting structures (transparency,</td>
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<td>motivation, quality)</td>
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<td>Develop governance, operational targets and KPIs, identifying issues in</td>
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<td>decentralized organizational structures</td>
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<td>Mindset and behavior</td>
<td>Identify cultural issues and roadblocks</td>
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<td>Provide coaching and feedback as instruments to develop a culture of change</td>
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<td>Develop communication and motivation activities in the transformation</td>
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<td>process</td>
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<td></td>
<td>Coach the leadership and management team</td>
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Operational excellence activities start with the process flow, but they incorporate dimensions such as employee skills and enterprise performance management that are supported by other operational enablers. The corporate culture is crucial for sustainable success with emerging consumers; activities around mindset and behavior are in many ways the basis for a holistic operational change.

In regard to challenges in the day-to-day business in emerging markets, there is a natural fit in using the operational excellence approach in change activities.

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<th>Requirements and success factors in emerging markets</th>
<th>Operational excellence approach</th>
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<td>Cost efficiency and high quality</td>
<td>Standardization</td>
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<td>Customer focus</td>
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<td>Ability to adjust to changing business environment</td>
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<td>Pragmatic solutions</td>
<td>Hands-on and bottom-up approach</td>
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“We believe that the years of easy wins for investors in terms of multiple expansion or financial engineering are over. To really create value you need to get your hands dirty, operate at and below board level and have a relentless focus on driving growth and operational efficiency.”

Niclas Thelander,
LeapFrog Investments
Investor’s take – why operational efficiency is critical for insurance investment

At the most fundamental level, investors take stakes in companies to gain a return on their investment. In a private equity context, a key part of the investment decision, from our perspective at LeapFrog Investments, is to evaluate and implement performance improvement levers that will translate into sustainable growth and efficiency improvements. Perhaps unsurprisingly, the ability to make operational improvements has increasingly proven to be the key source of value creation, and a vital success factor in delivering top-tier returns in the current market environment. This is a preferred alternative to relying on financial engineering or multiple expansions.

For most businesses targeting low-income, emerging consumer segments in developing markets, margins are likely to be low on a unit basis. This pressures cost efficiency across the value chain to service this segment profitably. The sheer size of the emerging consumer segment is the prize that awaits those who succeed.

LeapFrog’s profit-with-purpose investment strategy makes operational efficiency especially critical in these areas:

• **Affordability** – LeapFrog helps its portfolio companies to reach down the socioeconomic pyramid. Product pricing must be low and deliver meaningful value to clients; products must remain profitable and sustainable for the provider. Efficient operations are the key that enables companies to offer affordable products in combination with innovative product design and distribution access.

• **Quality** – Emerging consumers are, by necessity, savvy and aware; in many ways, they are more quality-focused than those in more affluent segments. Products that do not meet quality and value expectations are either not bought or not renewed. Of particular importance are claims payments. Typically, policyholders do not have large financial buffers and claims must be paid quickly. Insurers who fail to deliver on claims’ promises may face reputational damage.

• **Scalability** – LeapFrog’s ambitious goal to reduce financial exclusion helps investees grow quickly; in 2012, the average growth rate of its investees was 24.6%. As any fast-growing company knows, such growth rates pressure operations in different ways, and isolated or patchwork responses are unlikely to provide a scalable solution.
Conclusion

Incomes are rising in developing economies faster and on a greater scale than at any previous point in history. The global middle class will grow rapidly over the next 20 years and could constitute 50% of the world’s population by 2030. Financial inclusion will play an integral part in this development.

For insurers and investors in emerging markets, the future middle class is a huge business opportunity based on the number of potential customers and innovative solutions. There is also uncertainty about profitability and operational challenges that make the investment a bet on the future. In the end, the attractiveness and development of this market will be driven by investors who believe that market entry provides more opportunities for profit than alternative investments. We believe that more players will start investing in the insurance market for emerging consumers, either through their own operations or other vehicles or funds.

As the margins in the emerging segment are low, operational efficiency is important. Current business and operating models lean toward an internal setup. However, the more the market develops, the more it will merge structurally with the traditional insurance business in emerging markets and be enriched by new services and solutions.

Investors with a value-based investment style, driven by operational improvement activities, will play a dominant role in developing this new market segment. Operational excellence becomes a perfect solution for investors and insurers to support this growth journey and generate sustainable value in the emerging consumer segment.

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Express Life – making a difference in Ghana

The Ghanaian economy has been growing rapidly, with the life insurance industry increasing 40% Y-o-Y for the past five years. However, the majority of Ghana’s 25 million people still do not have access to insurance.6

With an investment of USD 5.5 million, LeapFrog Investments acquired a majority stake in Express Life, which primarily offers hybrid savings and insurance products to individuals. Its current business comprises employees in the public sector and other institutions serviced by its own branch and agents’ network. To achieve its ambitious growth targets, Express Life planned to penetrate the existing segments and push down-market with new products and distribution expansion.

EY supported LeapFrog and Express Life to design an organization that is lean, flexible and efficient at managing not only existing business, but also future products and distribution channels. The strategy focused on the key building blocks of the operational excellence framework that would help the organization jumpstart its next phase of growth, which includes:

- Ensuring efficient customer data capture mechanisms across the value chain
- Simplifying interfaces with the customer
- Decentralizing operations and focus on risk management
- Developing and hone skills across levels
- Making performance management a critical component

The value-creation efforts were recognized as LeapFrog announced the sale of its ownership stake in Express Life to Prudential PLC, a leading global insurer, in December 2013.

“LeapFrog’s intention was to support Express Life with both capital and entrepreneurial expertise gathered from other investments and the longtime experience of LeapFrog’s management.”

Doug Lacey, LeapFrog Investments

LeapFrog’s investments reach a total of 18.7 million people in 12 countries in Africa and Asia, providing financial tools and supporting over 48,000 jobs. Approximately 66%, or 12.2 million, of these people are low-income or underserved, and 12.9 million are women and children. The portfolio is fast-growing and profitable, with investees seeing average revenue growth of 24.6% in 2012. Their success demonstrates a compelling investment case for providing insurance to the emerging consumer.

In employing a profit-with-purpose approach, LeapFrog:

• Provides capital and expertise to businesses serving low-income consumers with insurance and related financial services, such as savings, pension and investment products

• Partners with successful companies in Asia and Africa to access the high-growth emerging consumer segment and businesses that focus on the low-income segment

• Invests across the value insurance chain in underwriters, risk-bearing entities, distributors, brokers and technology platforms that provide insurance

• Takes a significant minority or majority stake in each business as an active, hands-on investor
EY: helping to transform the insurance business in emerging markets

Insurance is one of EY’s largest sectors, with approximately 9,700 seasoned professionals worldwide dedicated to the industry and its business issues. We serve all of the Forbes Global 2000 top 10 insurance companies and audit 25% of the insurance companies on the list – providing us with the second-largest market share. Kennedy Consulting Research & Advisory recently named EY the leading provider of insurance advisory services globally.

In addition to our local presence in emerging markets, EY has established an Emerging Markets Center which connects clients quickly and effectively to the world’s fastest-growing economies. This enables us to share the breadth of our knowledge through a wide range of initiatives, tools and applications. Our in-depth and cross-border approach is supported by insurance professionals from emerging markets, business transformation and local regions.

EY supports you in both investment and improvement activities by offering assistance, from reviews to concept and strategy formulation to hands-on implementation support for transformation activities. We understand your specific situation based on our extensive experience and broad local knowledge, and we work with you to help develop solutions tailored for your organization.
If you would like to discuss any of the topics in this report or learn more about how EY can help your business, please contact us.

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