

WIDENING THE REACH OF INSURANCE IN SOUTH AFRICA -

A FUTURES PERSPECTIVE

By M Botha

ABSTRACT

This paper raises awareness of the futures studies field, a social science that incorporates qualitative-and quantitative research methods to explore possible futures and advocate preferable ones. Qualitative research methods are essential in addressing long-term strategic challenges.

To show the relevance of the futures studies field various methods are applied to the following insurance futures problem:

Widening the reach of insurance in South Africa to those in the second economy

Micro-insurance will get increasing attention going forward and viable strategies are needed to move the South African long-term insurance industry from a probable to a preferable future.

It is hoped that this paper will continue stimulating the collaborative action necessary to help improve the financial wellbeing of all citizens in South Africa.

The paper should be of use to all parties that have an interest in the micro-insurance industry of South Africa and the futures studies field in general. The insurance futures problem is primarily considered from established long-term insurers' perspectives.

KEYWORDS

Micro-insurance, long-term insurance industry, futures studies and methodology, complexity theory, scenario planning

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1. A “futures perspective” on the insurance industry

Dr. C. Rangarajan, Chairman of the Economic Advisory Council to the Prime Minister of India, said in his Convocation Address at the Institute of Insurance and Risk Management in Hyderabad in 2006 at a time when the insurance market started to open up, “*The approach to insurance must be in tune with the changing times.*” [Rangarajan: 2006]. This comment is very appropriate for the South African insurance industry today.

The long-term insurance industry for many years has been a pillar of strength in the South African economy. From one view it has been the backbone of financial security and risk management for many families. South Africa has one of the highest insurance penetrations in the world – premium income is almost 14% of GDP compared to an industrialized country average of 9% and an emerging market average of 4% [SwissRe: 2006]. From another perspective, however, it’s been failing to incorporate a large section of the population under this risk-security umbrella. This has led to criticism from government.

In recent years the industry has come under severe pressure to provide affordable risk management tools for poorer households, in line with government’s objective to increase access to financial services in this market [Republic of South Africa: 2008c]. Government, however, has been slow to implement policies that will both protect vulnerable low-income customers from abuse and attract market players through a favourable regulatory regime in this environment.

This expectation on private industry must be seen in the context of the continuous impact globalization has on the local economy and the insurance industry in particular. Insurers need to monitor a vast amount of factors that affect value for money, needs of customers and capital market forces. New technologies are emerging and are replaced at a faster rate. Threats of Asian flu and other epidemics hold unknown dangers to the population’s health and longevity. Customers are becoming increasingly aware of value being offered (or lack thereof) and demand greater flexibility in line with changing lifestyles. And competition in the local market is relegating historically leading insurers to lower leagues.

Addressing all of these challenges may seem impossible. The so-called un-insured population has its roots in various social, political, economic and cultural factors. The survival of the industry over the long-term, however, requires strategic action to be taken. Uncertainty is a constant to be managed, especially given government’s quest to turn around the dire wealth- and savings situation of a large portion of the population.

In his 2007 State of the Nation Address, Pres. Thabo Mbeki sketched an ideal “image of the future” for the South African insurance industry:

“...all South Africans will enjoy membership of a common, administratively efficient social insurance system, while those earning higher incomes will be able to continue contributing to private retirement and insurance schemes.” [Republic of South Africa: 2008a].

This is a picture of a “dual insurance” legacy: the continuation of the current market environment for high- and middle-income earners, but a substantially different environment for the poor through the introduction of social security- and retirement reforms. These reforms could potentially have significant impacts on private industry.

A perspective on what the future could hold for the private industry needs to be part of every insurer’s corporate strategy. And this perspective will probably need to be updated regularly as new information becomes available and new threats and opportunities arise. Long-range planning is thus essential.

An environment of rapid change requires new thinking that is both rigorous and creative. This paper wishes to highlight “new thinking” from the social sciences, in particular from the Futures Studies field that might be useful in addressing the above-mentioned challenges.

The paper starts by contextualizing the discussion from a Futures Studies perspective. It then defines the “insurance futures problem” for the industry, focusing on the micro-insurance market in particular. An ideal image of the micro-insurance market and its potential customer base is put forward, followed up with arguments for private industry to continue spreading its reach in this market. Two futures methodologies, complexity theory and scenario planning are then utilized to describe the broad insurance market as a complex social system and to explore alternative futures that might pan out for the industry. It is important to note that the above-mentioned issues are primarily explored from a large established insurer’s perspective.

2. Why a “futures perspective”?

There is wide acceptance that things will change in the insurance industry. The issue, however, is finding the answers to the questions of what needs to change, how to induce the changes in optimal ways and what the timeframes for implementing the changes should be.

The choice of the words “futures perspective” in the title of this paper is intentional. The paper tries to address the issues facing the insurance industry from a “futures studies” perspective.

Futures Studies is a “transdisciplinary social science” (Bell: 1997) and one of its nine key aims is that of integrating knowledge and values for designing social action. The futures studies field therefore offers relevant scope to contextualize the challenges facing the insurance industry since it is the “social architect” role of the industry that is being called upon in the current political- and economic environment.

A central theme in futures studies is the notion of placing social items on the national agenda and ensuring that sufficient awareness is raised to institute social change. This notion of serving the public interest is not new to the insurance industry. The industry, however, needs to be reminded that what is needed is thought leadership to ensure sustainable social change – and then in the second instance social change that will create a platform for companies to excel. This is a key difference between strategic planning and futures studies.

Futures Studies furthermore has at its heart “prospective thinking” (Bell: 1997). Its aim is to improve foresight in the decision-making process that will lead to the creation of the best future possible. It also encourages collective dialogues from a multiple of perspectives.

Slaughter (X: 1993), in defining concepts of the futures studies field, stated:

“The principle of foresight is clearly one of the main keys to a livable future, but it is not yet well understood or widely applied...People cannot 'know' the future in any precise sense. Yet at the same time they necessarily look ahead both to prepare for contingencies and to assess the likely results of their actions. Prudence and responsibility both emerge from forward thinking.”

Most role-players in the industry are already “forward thinking”: customers anticipate key life events for which they need insurance cover to protect themselves; insurers base product design on projected needs of groupings of the general population. Much of the industry’s success has been based on strong technical forecasting input from actuaries, statisticians and economists. Government also is interested in the current and future welfare of its people and tries to sustain the stable financial markets needed for all parties to properly engage.

If this forward thinking by all role-players and targeted social design can be merged it could be a recipe for long-awaited success. For a long time however, due to vested interests, the various role players in the insurance industry did not come together to formulate a cohesive response for social security. Although not always justified, private industry has been accused of ignoring the call for social welfare. If the industry, however,

wants to reverse the current situation it should focus on proper long-term planning, especially in a complex industry such as insurance.

The industry now needs to critically explore and understand a range of **alternative** paths the future can take and analyze the **choices** available in each of these. Thinking about the future is crucial when societies transform themselves.

Bell, a futurist, stated, “*The primary goal of futurists is not to predict the future, but to uncover images of the possible, probable and preferable futures that enable people to make informed decisions about their lives.*”

[Bell: 1997]

3. Defining the insurance futures problem

There are many challenges facing the local long-term insurance industry in South Africa and the markets they are serving. These driving forces influence the current insurance landscape of established insurers and also the likely scenarios explored in Section 6.2 of this paper. Some of these include:

- Managing costly policy administration systems, whilst introducing modern alternatives for new product developments. The result is a wide variety of systems that need to be maintained.
- Balancing the interest of policyholders and shareholders in a competitive environment where value for money to customers often conflicts with the pressures of increased return-on-capital to shareholders.
- The growing consumerism and financial astuteness of certain customer market segments.
- The demographic factors on which the industry is based are largely complex with changes in nature and trends:
 - Improved longevity for a broad section of the population due to better standards of living.
 - The continued impact of HIV/ AIDS and other diseases on population growth.
 - The influence of emerging illnesses (eg. Asian flu) on morbidity rates.
- Communicating financial results to investment analysts worldwide in a manner that highlights strengths and weaknesses, without negatively affecting perception and share prices, is tricky.
- Product proliferation.
- Competition from non-insurers.

There is, however, another challenge facing the industry in which the South African government has made its expectation clear. It wants to “*catalyse the market provision of risk management tools for poor households*” and private industry therefore needs to get more involved [Republic of South Africa: 2008c].

Insurance futures problem

For the South African long-term insurance industry as a whole, it is argued here that the over-arching “futures problem” is that of widening the reach of insurance (and wealth building) to those in the second economy. From an individual insurer perspective, however, the response will center on the issue of commercial viability. Insurers don’t like selling products at or below cost. . They may write loss leaders or products with low margins if it gives them a license to operate, but they prefer serving market segments from which reasonable profit margins can be earned.

The context for this futures problem is government’s plan for some form of basic insurance cover from the proposed National Social Security Scheme [Republic of South Africa: 2008b]. These changes form part of broad Social Security and Retirement Reform aimed at improving the lives of the poor. Current proposals include mandatory contributions for all South African employees to a national retirement fund up to a certain income level. Above that employees will have a choice to invest either in the same fund or with private industry funds. This will lead to many low-income individuals saving for retirement in a formal way for the first time and these savings will need to be channeled to annuity providers post-retirement. It is furthermore envisaged that the means test and qualifying age for old age grants will be revised.

Although retirement savings is a key business of insurers, the scope for this paper has been narrowed to look primarily at risk benefits. What will be the impact of the above on insurers’ risk-product business models?

Futures Studies is not about defining single questions or solutions. It can rather be compared to the “open-source movement” [Taylor: 2006] where it is about a collaborative approach to exploring future challenges and finding solutions for them. Collaboration is exactly what is needed to face the insurance futures problem.

Micro-insurance framework

Micro-insurance refers to insurance products targeted at low-income households. It forms an important social security tool as the impact of severe uncovered risks on the poor can result in serious delays in the asset formation process. It is a relatively well developed market, but primarily based on funeral insurance and characterized by a number of challenges [Republic of South Africa: 2008c].

In April 2008, as part of social reform, National Treasury released a discussion paper on the future of micro-insurance regulation in South Africa [Republic of South Africa: 2008c]. It proposes a regulatory framework for micro-insurance that will hopefully remove some of the stumbling blocks insurers face in servicing the low-income market and to expand the product offering in it. It explicitly states the preservation of private industry risk cover. It also emphasizes affordability and the need to protect the poor from potential abuse and mis-selling. [Milazi: 2008].

If affordability is an issue, it is only fair to ask whether private industry should focus at all on the poor. Business practice dictates that people with higher disposable incomes provide more sustainable, and generally more profitable, target markets. Do the poor offer viable opportunities?

The quick spread and saturation of cellphone technology in all income segments in South Africa is only one example to prove that the low-income market can provide commercially viable opportunities.

If we can live with a “dual-economy” in this country, why can’t we live with a “dual insurance industry”? A commercially viable, fair and equitable insurance industry in the lower income segment... Is this an ideal image of the future?

4. The micro-insurance environment

4.1 Ideal image of the future

In the recently published LOA gap study, “Measuring the insurance gap by reference to the financial impact on South African households of the death or disability of an earner” it was found that depending on the extent to which households want to maintain their standards of living after the death of an earner, the life insurance gap in South Africa is between R2.6- trillion and R4.3- trillion for household units [Hugo, Zondagh: 2007]. This gap is measured as the difference between “ideal cover” and “actual cover”. Similarly, the disability insurance gap is between R3.1-trillion and R6.0- trillion. The study focused on household units that include a primary earner as well as secondary earners. Table 1 below gives a summary of the findings.

The estimated cost to close the total gap is between R19.7bn and R34.4bn a year [Hugo: 2007]. This translates into 2.2% to 3.9% of annual household expenditure.

Table 1: Life and Disability Cover Insurance Gap in South Africa

Source: [Hugo: 2007]

R'billion	Life Cover		Disability Cover	
	Preservation of living standards	Belt-tightening	Preservation of living standards	Belt-tightening
Ideal Cover	7 859	6 108	12 326	9 551
Total annual expenditure	876	876	876	876
* Replacement ratio	* 67%	* 53%	* 95%	* 75%
* Capitalisation multiple	* 13	* 13	* 15	* 15
Actual Cover	3 535	3 535	6 323	6 489
Insurance: Retail	1 862	1 862	1 249	1 249
Insurance: Group	1 673	1 673	3 231	3 231
Government Grants	-	-	1 843	2 009
Insurance Gap	4 325	2 573	6 003	3 062
Gap as % of Ideal Cover	55%	42%	49%	32%
Gap as % of Actual Cover	122%	73%	95%	47%

The insurance gap was found to exist at all income categories, not just the poor. But if one is to believe Anthony Asher's claim that one half of the population is over-insured and the other half have no insurance [Asher: 2005] it is reasonable to assume that the greater challenge lies in the second economy where access to work, sustainable levels of income and basic financial services products are low at best.

The table below, which supports the above assertion, gives an indication of the insurance penetration in this low-income market for LSM 1-5 adults:

Table 2: Insurance penetration for LSM 1-5 adults in South Africa

	Insurance penetration
Formal Funeral Cover	33%
Other Life Cover	2%
General Insurance	0.5%

Source: [Republic of South Africa: 2008c]

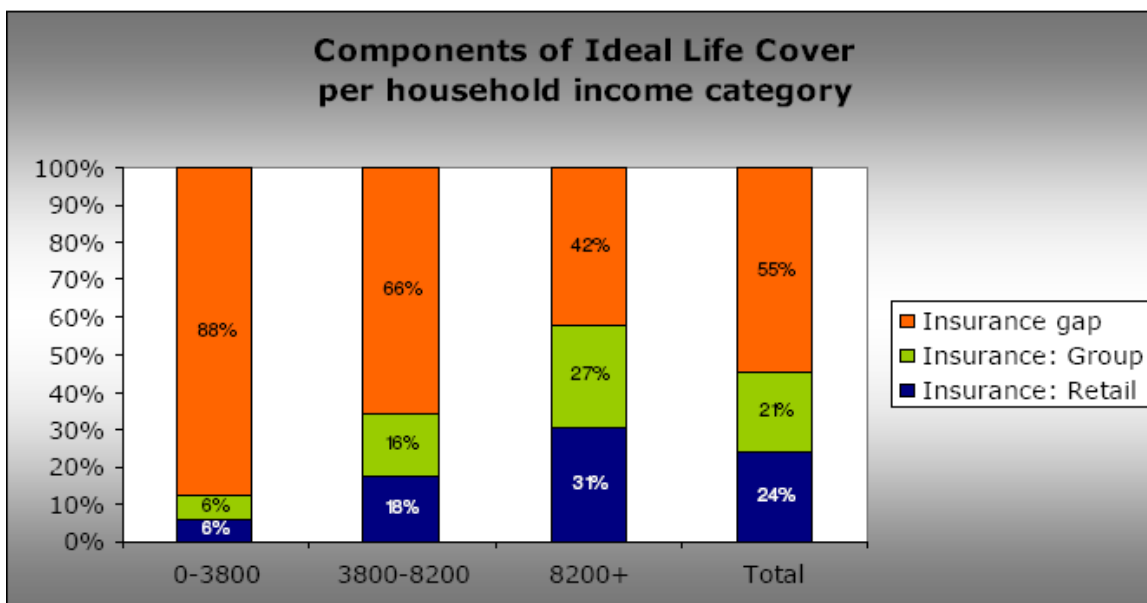
Research by Unisa's Bureau of Market Research shows that in the lowest income-earning band only 1% of total expenditure is directed towards insurance expenditure [Martins: 2004] and also only 1% to savings. Savings here refer to retirement savings and other wealth creation. This compares to 7% and 3% for the highest income-earning band. These findings also support the above assertion.

The LOA gap study furthermore showed that this lower-income market is quite large - 60% of South African households by number have an income below R3800 per month [Hugo: 2007].

Table 3 shows the calculated components of “ideal levels” of insurance cover and the associated gaps per household income category. The life cover insurance gap is estimated at 88% for the lowest income-earning households and far exceeds those of the other income groups.

Table 3: Components of Ideal Life Cover Per Household Income Category

Source: [Hugo: 2007]



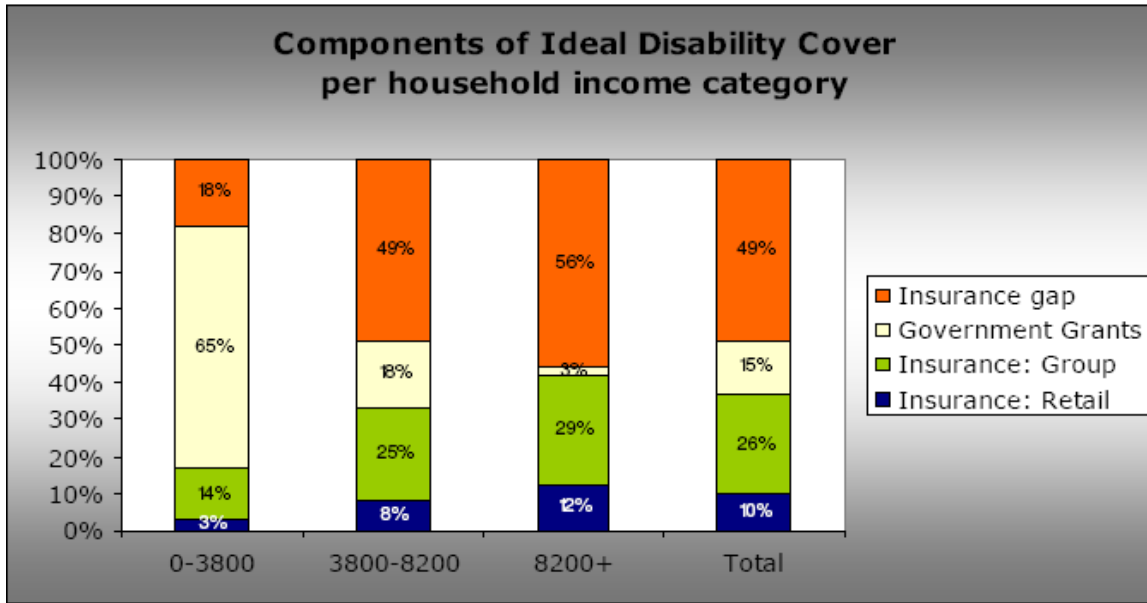
The picture is quite the opposite for disability cover highlighted in Table 4, where the estimated gap is small due to the effective nature of government’s current disability income grant for these households. Understanding this difference will be key if the industry is to reach this market effectively and cost-efficiently.

Although social security benefits are expected to help reduce the insurance gap, the size of the benefits will be limited. It is also envisaged that the proposed micro-insurance framework will not cover funeral policies for example [Republic of South Africa: 2008c]. So there seems to be sufficient scope for private industry to extend their risk product ranges in this market if it can be offered on an affordable basis.

So what is National Treasury’s ideal image of the micro-insurance future?

Table 4: Components of Ideal Disability Cover Per Household Income Category

Source: [Hugo: 2007]



The proposed micro-insurance regulatory framework will most probably be characterized by:

- A simplified distribution regime to improve competition, and uncapped commission levels structured on a hybrid basis (part of the commission paid up-front and the balance paid over the term of the policy on an as-and-when basis) to reduce the cost of intermediation.
- A combination of life and property classes of insurance with contract terms no longer than one year being sold under the same license. Property classes of insurance will be introduced under the framework to reduce more broadly the vulnerability of the poor and bring long-and short term insurance under the same simplified regime for this market. So even though products will be individually sold they would be underwritten on a group basis.
- Benefits that are capped at pre-determined levels per individual risk per year
- Reduced capital requirements and regulatory controls to reduce operational costs
- The explicit exclusion of savings business from the framework

[Republic of South Africa: 2008c]

So future benefits in this market will not be limited to those associated with life products only, but will include those generally associated with the short-term insurance market.

Distribution will be a key aspect to help drive the above ideal future. Simple and cheap distribution models are needed. The poor levels of financial education and the low awareness of insurance products currently in this market, however, make it difficult for insurers to identify which technologies to utilize to reach the un-insured. And beyond that they need to overcome the issue of trust as well in this multi-dimensional value dynamic.

Technology and innovation therefore needs to play an enabling role in the “insurance experience” of poor households. It needs to help overcome the complexity and intangibility of insurance products.

Insurers have been employing a number of distribution technologies in the micro-insurance market to date each with their own advantages and disadvantages including:

- Tied agents (employees of insurers)
- Burial- and friendly societies (other direct writing organizations)
- Micro-finance operators.
- Telephone sales

These forms of distribution were mainly advice-based.

Innovative sales-and business models have also come to the fore due to the relatively high costs of advice-based intermediation in this market:

- Cell captive arrangements (special purpose insurance vehicles set up to utilize self-insurance mechanisms)
- Retailer networks (a partnership between an insurer and a retailer)
- Industry formalized stokvels
- Banks’ ATMs to collect premiums and pay claims

With an increased focus on volatile customer clusters and structured multi-distribution strategies [Capegemini, 2008] for all income segments, the Internet and mobile technology will probably play key roles in the micro-insurance market as well.

One would expect that more customers in SA would be ready to use self-directed alternatives like the Internet in future. With the costs of telecommunications expected to come down with the launch of the SEACOM optical cable and with levels of education expected to increase a greater number of poor households may have access to the Internet. Mobile technology, however, may become the one technology that will allow insurers to balance

customers' need for human interaction (advice-based intermediation through an individual call, SMS or video-call) with low-cost non-advice based intermediation (Internet browsing). Although it has already been introduced in the micro-insurance market it is yet to be fully utilized.

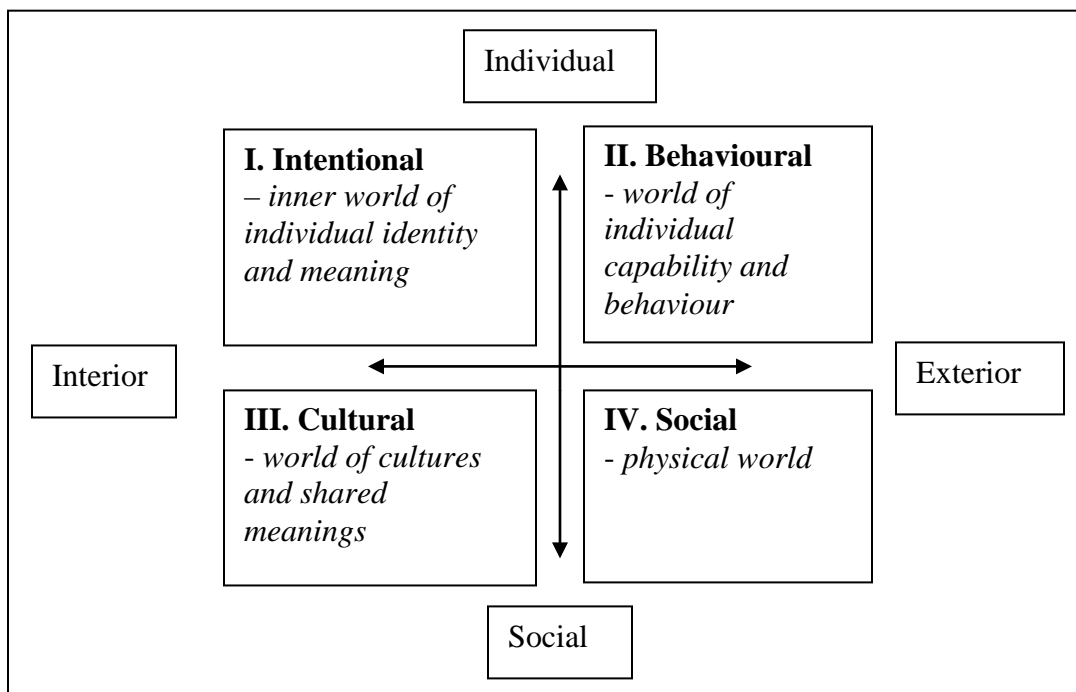
Sufficient awareness of formalised private industry products will need to be created to attract those low-income earners that are used to turning to government for assistance. This awareness will be no small feat to achieve. The demographic profile of lower-income households is significantly different as will be shown in the next section and this market contains strong community-based support networks that offer protection on an informal basis. Marketing and financial education at such a large scale will be a tremendous challenge.

4.2 An image of the future client base

Key to designing micro-insurance products that will be desirable is an understanding of the needs of potential customers in this market. For this insurers will need to “tap into the internal, intuitive, subjective ways of knowing...” [Hines: 2002] that will define the worldview of these potential customers.

Diagram 1 below shows Ken Wilber's four-quadrant model [Hines: 2002] that is used in the futures studies field to map behavioural patterns. It can be applied to project the make-up of a potential micro-insurance customer that is economically active and earns a relatively stable income stream. It shows that an individual's worldview is influenced by both individual- and social needs, as well as the interior- and exterior environments.

Diagram 1: Ken Wilber's four-quadrant model



Insurers will need to do research into how each of these four quadrants will influence insurance needs and disposable-income spending patterns. And they need to be mindful that these patterns may change as customers move from the low-income to middle class segments. So the focus should not just be on the poor in searching for micro-insurance solutions. Their transition to the middle class should be kept in mind as it would be ideal to retain them as insurance customers in that phase as well.

The discussion will be narrowed to the characteristics displayed by the emerging black middle class.

Emerging black middle class

Research by the Bureau for Economic Research found that the consumption patterns of the black middle class in South Africa differ from those of white people, “*even when considering income levels and household size*” [Nieftagodien, Van der Berg: 2007]. Assuming that insurance products in the past were designed to meet the needs of white people, to what extent should they change to meet the needs of the black emerging class?

One might be tempted to start with an exploration of cultural differences between a “black diamond” vs. a white middle class individual in each of the above four quadrants to understand needs differences. The research conducted by Nieftagodien, however, proves that consumption spending is different not due to differences in taste for middle class goods, “*but from an asset deficit experienced by blacks*” [Nieftagodien: 2007]. The black population generally has had a shorter time to accumulate assets than their white counterparts.

This is not a simple case of the “haves” and “have nots”. There is also research available that highlights the issue of significant intra-group inequality amongst black people [Bhorat, Leibbrandt, Maziya, Van der Berg & Woolard: 2001].

After consideration of the asset deficit, consumption spending of black people on middle class goods exceeds those of white people [Nieftagodien: 2007]. And while the elimination of this asset deficit will certainly take some time, insurers need to target different groupings of the black middle class if the above research is indicative of a long-term trend. There are those black people that have already accumulated wealth and generally spend and consume in line with white people, and there is the group that prefers consumption spending to savings. Insurers will need to attract flows from the available disposable income from this relatively un-insured group.

Other than the issues above, insurers need to understand the needs of asset-poor blacks in general to improve their individual statuses in society, their self-actualisation, their generally higher involvement in community support structures etc. These inner world and cultural frames of reference will ultimately influence their take-up of insurance products in the micro-insurance space. Increasing workplace mobility due to the effects of affirmative action locally and the opportunities globalization offers also lead to a need for products to be flexible and not penalizing.

Other stumbling blocks in extending insurance products to the low-income segment that need to be overcome are [Milazi]:

- Demystifying the complexities tied up in insurance protection (the need for simpler product structures and communication)
- A perception in this market that insurance products are only affordable to or needed by the higher income classes.
- Challenges involved in collecting premiums in a market that owns a low number of bank accounts.

Current demographic changes in South Africa mean increasing incomes and asset growth for a large proportion of the current un-insured population. This should surely lead to a view that there is some potential to be tapped by servicing the lower-income segment – even be it as a “temporary strategy” until asset deficits have been reduced and low-income earners move to higher income categories.

4.3 Commercially viable opportunities

Some long-term insurers have already introduced products in the lower-income market. There is, however, not a lot of research available on the success thereof. What is known is that there are a substantial number of illegal operators in this space selling mostly funeral business [Republic of South Africa: 2008c]. This suggests that there are commercial opportunities in this market if regulatory- and other costs can be kept low.

Regulation has increased the cost of financial advice and has been a contributing factor to the bifurcation of the insurance market into advice and non-advice based intermediation. Non-advice based models should surely help to reduce costs in the micro-insurance market [Republic of South Africa: 2008c]. The increased risk of mis-selling by insurers and the resultant reputational damage that usually follows it, however, should be avoided. These lighter regulatory controls currently proposed by National Treasury for the micro-insurance market should therefore increase commercial opportunities in this space.

Innovation and the efficient use of technology are also key drivers in reducing operational costs in reaching this market. The widespread use of mobile technology and the expected reduction in telecommunications costs in South Africa seem promising in this regard. Since the field of possible technological innovations that could be deployed is so vast, it falls outside the scope of this paper.

So the micro-insurance market will most likely see a greater use of mobile technology and other web-based applications to distribute products. It is debatable, however, to what extent the advice component in intermediation will fall away. Any unnecessary regulatory barriers that prevent the introduction of new technologies and business models will also have to be avoided in the new regulatory framework [Republic of South Africa: 2008c].

In any market, however, economies-of-scale is important. Insurers aim to minimize the fixed costs in running their operations by spreading that cost over as large a customer base as possible. Bringing more people into the insurance context should then benefit all role players in the industry.

In order to reach the large sales volumes to make micro-insurance products really profitable the poor savings rate of the nation will need to be addressed. This is potentially the area where insurers can play a leading role by investing in financial education projects and reap the commercial benefits at the same time.

National savings has two key impacts on an economy:

- It acts as stock piles of capital for future investment, and
- Future investment will determine the level of households' future income

[Schneider and Tufano: 2005]

In order for insurers to benefit from an increased investment rate in SA, there needs to be an increased savings rate – even for poorer households. The gains for insurers might not be immediately realized, but over the longer-term a larger pool of savings will find its way to insurers' investment- and risk products. A widening social security net will create more financial stability; an improved environment for wealth creation; higher investment capital; and ultimately higher growth in the economy.

“The marginal returns of increasing the financial assets of less affluent families must be higher than increasing the financial assets of the affluent. Adding...savings to a low-income family living close to the edge will surely

have a bigger impact on their lives—and on society— than adding the same amount to a wealthy family's balance sheet.”

[Schneider, Tufano: 2005]

The dynamics, however, are more intricate than offered above. An increased savings- and investment rate ultimately shifts demand from risk products to investment products, a market in which insurers are not the only operators. Marginal benefits realized are furthermore not always passed on from companies to customers. This highlights the issue of complexity in addressing social problems.

The rest of this paper applies complexity theory as a framework for tackling the insurance futures problem and explores alternative futures through a scenario-planning exercise.

5. Complexity framework

Long-term insurers in South Africa and all over the world are increasingly faced with the threat of complexity in their operations. Most staff, and even experienced managers, find it difficult to understand the complexities of all the factors that influence their current insurance product ranges, services, roles in the organization, target markets, clients etc. Projecting these complexities for the micro-insurance market in which they have little or no experience will be even more challenging. The changes demand a rethink of competition, innovation and customer interaction. Understanding this complexity is key to exploring probable and preferable futures.

Researchers from the Millennium Project [Glenn, Gordon, James: 2001] listed the following two factors (amongst others) as impediments to the timely use of alternative futures research:

- Personnel
 - “Lack of decision skills – decision makers do not understand the complexities of the issues about which they must decide.”*
- Complexity
 - “Lack of understanding of the magnitude of problems; lack of models showing the complex interdependence of events and policies; lack of understanding of consequences of actions; stereotypical thinking.”*

5.1 Managing internal organizational complexity

Cutting on operational per-policy costs, a requirement for entering the micro-insurance space, will require that superfluous layers of complexity in products and the internal organizational structure be removed. Government is encouraging new entrants in the micro-insurance space [Republic of South Africa: 2008c] and these organisations will look into introducing more cost-effective and modern systems to provide a competitive edge above traditional insurers. Existing players therefore need to seek opportunities to simplify their operations in order to unlock value if they are to compete. Establishing non-advised based sales models, streamlining product ranges with specific focus on standardization, targeting specific geographical regions, automating internal processes and outsourcing certain back-office functions are all options to be explored.

Removing unnecessary costs, however, may not create new long-term value. Managers need to be aware of areas where they can get away with using high-level, simplified approaches to deal with services, products, systems and reporting without causing costly errors over the longer term. At the same time they need to know when to push for more complicated solutions where a simplified approach may not generate an optimal yield.

Research by McKinsey argues that, *“When companies treat complexity as something they must overcome, they miss an opportunity. If complexity, in all its aspects, is seen as a challenge to be managed and potentially exploited, not as a problem to be eliminated, business can generate additional sources of profit and competitive advantage. Managed well, complexity can also increase the resilience of a company by enhancing its ability to adapt to a changing world.”* [Spungin, Turnbull, Heywood: 2008]. Targeting complexity in certain areas and hedging against complexity in others therefore seems to be the challenge facing insurers.

The following areas of complexity could be targeted [Spungin: 2008]:

- Organisational complexity (institutional complexity)
This covers the various levels of interaction within long-term insurers (operating systems & functions) and outside of them (relations with clients, regulators, government, competitors, and industry bodies).
- People complexity (individual complexity)
This covers the way in which staff and customers react towards change.

Insurers will need to consider the impact of reducing organizational complexity on their staff and customer-service. They should guard against the risk of destroying more value than that created from reducing a certain function. Resources should also be directed towards identifying and reducing the level of people complexity through intelligent organizational, functional and systems changes. These include clarifying roles, resourcing at the right levels, proper skills development etc. For example, management of simpler products in the micro-insurance market does not necessarily require expensive actuarial expertise. Through proper training these resources could be replaced with less costly ones. This comes with a warning though - risk management agendas should remain a priority to ensure that misdirected action in one area of complexity does not adversely affect all other avenues taken.

It would be foolish to simply advocate that overall simplicity in product design and strategy will guarantee success in tackling the insurance futures problem. Targeted simplicity, however, could create the required opportunities. Insurers that properly manage the complexity of serving different target markets may have a greater chance of outperforming their peers.

The different areas/ roles of complexity [Spungin: 2008]] that could be targeted in defining a micro-insurance strategy are:

- Senior management roles
 - This is a concentrated location for entertaining the insurance futures problem and will probably remain there in the initial phases.
 - It demands high capability and leadership of senior management to engage government and other stakeholders to help find an optimal regulatory framework.
- Specific level within the organization
 - Over time, as the proposed regulatory framework becomes more clear and insurers start committing to the micro-insurance market, more staff will start seeking solutions to the challenges ahead.
 - Insurers will need to start building the capabilities needed to implement product developments.
- One sliver of the organization (business, function, geography)
 - A particular business unit will eventually be established to research customer segments in this market, develop the products and manage them.
 - This level requires more complex interactions with other units eg marketing, systems development etc within the organisation and should be appropriately staffed with a wide diversity in skills present.

- Throughout the organization
 - Over time it is possible for a micro-insurance unit to become completely self-reliant. There is also the possibility of establishing separate corporate entities to enter the micro-insurance market.
 - This is probably what government has in mind in promoting SME development in the current regulatory proposals [Republic of South Africa: 2008c].

From a futures perspective Inayatullah argues that capacity building is necessary in order to build individual and organizational confidence in dealing with change and possible futures [Inayatullah: 2004]. The more industry professionals are trained to “think futures” the greater the chance of understanding complex probable and preferable futures. This is not negotiable if long-term insurers want to enter the micro-insurance market in which they currently have limited or no experience.

5.2 Complexity theory

Appropriate methodological tools need to underlie any attempt at providing thought leadership. Complexity theory, a relatively new development in futures studies, could assist insurers in this regard. Elements of its theory are useful in describing social systems.

Social systems are often defined as “complex” when they have the following characteristics: [Gharajedagh: 1999] openness, purposefulness, multidimensionality, emergent property and counter-intuitiveness. Openness refers to the system’s positioning in an environment – it does not operate in isolation. Purposefulness refers to the system’s aim of following a certain path. Multidimensionality not only refers to multiple structures or functions, but also that outcomes and ideals may seem contradictory and conflicting. Emergent properties focus the attention on the dynamic inter-relationships between various parts of the system. And counter-intuitiveness highlights to the observer of a social system that reactions to change are often the opposite of what is expected.

Cilliers’ differentiation between systems that are “complex” and “complicated” is useful in the determination of the micro-insurance industry as complex [Cilliers : 1998]. *Complicated systems*, no matter how many elements or the magnitude of the interactions among these elements, can be described fully by reference to the individual constituents. In such systems it may take a while to understand and describe the role and interaction of each element, but all elements can be placed in the puzzle to complete the whole picture. *Complex systems*, however, cannot be described wholly by analyzing the individual elements. The interactions among the various elements

are so rich and dynamic in nature, and the interaction between the whole system and its environment changing so often due to self-organisation, that the “whole” cannot be fully understood.

From the discussion so far it seems reasonable to classify the micro-insurance industry as a complex social system and to consider the following:

- The industry operates in the unequal wealth environment of South Africa that encapsulates a first and second economy (openness)
- The primary aim of the industry is to provide financial stability and wealth-generation means to households. Government wants it to act in the *“provision and distribution of good value, low-cost products that are appropriate to the needs of low-income consumers by a variety of market players, who must treat their policyholders fairly and manage the risks of providing insurance.”* [Republic of South Africa: 2008c] (purposefulness)
- Government’s ideal to bring the second economy into the insurance framework without necessarily promoting free market economies conflicts with commercial enterprise and could lead to low involvement from private industry in the micro-insurance environment (multidimensionality)
- Government needs the private industry to help deliver on the micro-insurance vision and provide access to products. Private industry does not need a stifling or costly regulatory regime. Poor households depend on government and private industry to improve their wellbeing. Private industry is dependent on stable financial markets and a savings culture from the population. (emergent property)
- Government’s drafting of legislation, with well meaning intentions, could have the opposite effect and make it unattractive for private industry to enter the micro-insurance market. Misselling sometimes occurs unintentionally, leaving the customer worse off and misaligned incentives due to the structure of intermediary commission may also impact the risk of harm (counter-intuitiveness)

A danger in seeking solutions for the insurance futures problem is an inadequate understanding of the above-mentioned interactions between various parties.

In order to accept complexity theory as a method for describing social phenomena one has to accept that there are elements in a system that cannot be fully understood. And then one needs to deal with this by thinking differently.

Cilliers’ proposed definition of “complexity theory”, which expands on the above, has been chosen as a framework for approaching the insurance futures problem [Cilliers: 1998]. He offers ten characteristics of complex systems to help describe the elusive term:

1. Complex systems consist of a large number of elements, often difficult to quantify.
2. A large number of elements are necessary and these elements have to interact dynamically.
3. The interaction among these elements is fairly rich i.e. elements influence one another.
4. The interactions are non-linear i.e. small causes can lead to large impacts.
5. The interactions usually have a fairly short range (elements communicate with immediate neighbours), but could have wide influence.
6. Recurrency: there are loops in the interactions and the degree of and route of the feedback can change.
7. Complex systems are open systems and interact with their environment. Observers often frame the system from their point of view.
8. Complex systems depend on constant energy to be maintained and therefore operate far from equilibrium.
9. Complex systems have a history, evolve over time and are therefore incomplete without the dimension of time.
10. Each element in the system is ignorant of the behaviour of the system as a whole and responds only to the information that is available to it locally

Thought leaders in the insurance industry would do well in considering the above characteristics and the implications thereof when facing the challenges in the current- and future micro-insurance dispensation. Section six will end with an example where the above characteristics are combined with scenario planning to “map” a probable future.

This paper by no means wishes to simplify the complexity of the insurance futures problem. The use of simplified models and their applications should not be read in this light. The study aims to derive “possible” and “probable” futures that may likely arise for the industry and it is hoped that the insights offered will stimulate debate so that a “preferable” future can be pursued.

A danger in using any “futures methodology” is the perception that a simplified “model of reality” cannot lead to substantive claims about the future. As all models are simplifications of reality one cannot ignore this concern. Yet there is no overarching methodology that can encapsulate any complex system or its future accurately and comprehensively in any field. This does not mean one should not attempt to use such methodologies to illuminate at least something worthwhile that could be of interest.

Qualitative methodologies furthermore, such as complexity theory and scenario planning, are better at projecting the future. Quantitative measures of the future fall flat over the long-term.

6. Probable futures for the broader insurance industry

Section 4.1 described an ideal image of the micro-insurance industry, a preferred future. It is of course recognised that there could be more than one probable outcome of the future. And, to induce peripheral thinking (that often leads to creative stimulation), one needs to consider all possible future outcomes.

Scenario planning provides a useful methodology for focusing on probable outcomes [Ratcliffe: 2002]. A combination of the complexity framework above and scenario planning below gives an interesting perspective on the insurance futures problem.

Scenario planning

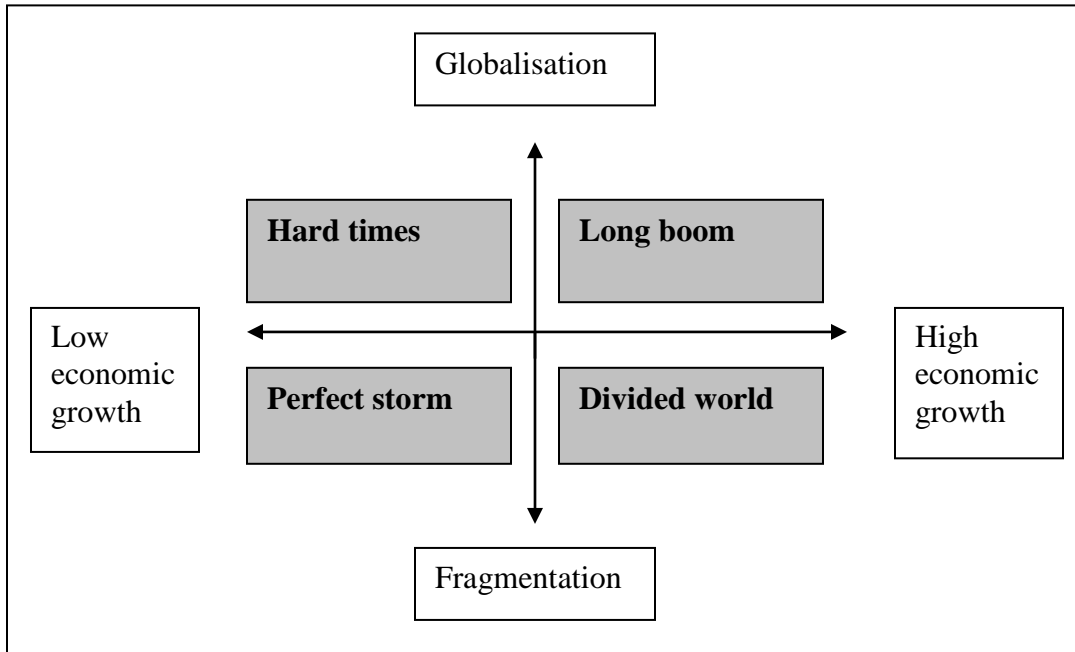
There is a wide range of possible scenarios that may pan out for the insurance industry in the years to come, even if one is to ignore the micro-insurance regulatory framework developments. Even unlikely scenario's, such as a complete collapse of the insurance industry due to nationalization, should be noted. Useful ideas may come forth from projecting such "images of the future". None of them should be dismissed outright. The usefulness of scenario planning lies in the glimpse it provides of the future. This enables decision-makers to engage in constructive dialogues in order to create desirable strategies. It does not form a single understanding of the future, but allows for differences in opinions and understanding of the then and now.

Four possible, and all probable, futures for the micro-insurance industry have been chosen for this discussion. Each is based on Clem Sunter and Chantell Illbury's most recent scenario planning exercise for the future of South Africa [Sunter, Illbury: 2008]. Below in Diagram 2 is their simple scenario game board in which globalization and fragmentation are two opposing forces on the one axis, and high- and low global economic growth the other. This design yields four scenarios.

The long boom scenario hypothesizes high future economic growth for South Africa in which it becomes a globally competitive player. The divided world scenario also assumes high economic growth, but increased forms of protectionism that leads to fragmentation and isolation. The perfect storm scenario and hard times scenario, however, project low economic growth with the difference being the bigger political challenges emerging in the perfect storm scenario.

Diagram 2: Four scenarios of the long-term future of South Africa

Source: [Sunter: 2008]



Sunter's outcomes were based on a time-horizon from 2010 and beyond. The micro-insurance regulatory changes are also only likely to be implemented post 2010 [Republic of South Africa: 2008c], but the effects may only be realized many years later. The projected industry scenarios below are therefore based on a view of the industry from 2020 to 2040.

Economic and political changes over the short- and medium-term will influence the long-term success of these micro-insurance developments.

What could the insurance industry look like over the long-term in each of these scenarios?

Regardless of which scenario pans out, global issues will ultimately affect the South African environment and in turn the local insurance industry. Scanning global industries, and the insurance industry in particular, helps to identify emerging patterns that are useful for stimulating debate on where the industry is heading. An ongoing scan of global trends is therefore key in answering to the insurance futures problem.

6.1 International trends and emerging issues

With reference to the environmental characteristic of complex social systems it is important not to forget the changes occurring on the international insurance scene. One may be tempted to view the insurance industry as isolated from developments around the globe, but no industry can claim to be unaffected by the impact of globalization [Friedman: 2000]. Global economic, political, technological and socio-economic factors will certainly influence the local insurance industry's maneuvering in the micro-insurance space.

International trends

The following general observations regarding global issues that could influence South Africa's micro-insurance market in the future are:

- Embracing strategic economic partnerships with the East is an imperative as economic power begins to shift from the West to the East.

“In 2006 and 2007, 124 countries grew their economies at over 4 percent a year. That includes more than 30 countries in Africa. Over the last two decades, lands outside the industrialized West have been growing at rates that were once unthinkable. While there have been booms and busts, the overall trend has been unambiguously upward...It is the rise of the rest- the rest of the world.

[Zakaria: 2007]

- Insurers that can take advantage of the industrial revolutions in China and India will succeed.

“The insurance industry in our country is on the threshold of a new era of rapid expansion. A more competitive environment is emerging with new participants entering the insurance industry...”

[Rangarajan, 2006]

Rangarajan's argument was based on the view that *“In the developing economies because of the savings component and the long nature of the contract, life insurance has become an important instrument of mobilising long-term funds. The savings component puts life insurance in direct competition with other financial institutions and savings instruments...The insurance penetration i.e., premia as percentage of GDP was 3.17 per cent in 2004. While this ratio is steadily increasing, it is far below the world average of 8.06 per cent. This shows the vast potential that exists.”*[Rangarajan: 2006]

- Survival in the West will be dependent on technological advances.

Technology will continue to drive developments in all sectors. These opportunities need to be implemented in order for companies to remain competitive. The insurance industry in particular would need to keep on adapting to new technologies that could influence its product administration platforms and sales models. For example, are there opportunities to be gained from developing insurance products on the principles of open-sourcing? [Taylor, Labarre: 2006]

- Opportunities will be available in Africa with Africa emerging as a key partner in China's resource driven economy.

Many insurers and banks are increasing their operational footprint in Africa. Many ideas from the implementation of micro-insurance products in the South African environment could find commercial viability in the rest of Africa where similar demographic and economic profiles exist.

- The impacts of global warming and natural weather disasters on claims rates for short-term insurers, long-term insurers and reinsurers are uncertain.

The impact for insurers could be via increased death rates due to disasters or catastrophes. The cost of reinsurance and other risk management measures are also likely to increase in such scenarios.

- Emergence of new diseases that could plague developing economies.

This could change the face of underwriting. There could be an increase in the number of contractual exclusions. Or it could lead to additional operational and claims costs not originally allowed for.

- A combination of declining fertility could lead to a smaller economically active young population relative to elderly people.

This will place a burden on pension and healthcare systems around the world to support the elderly for longer [Dixon: 2008]. The flipside is that the elderly can make a longer contribution to the economy [Brown: 2005]. Although a large portion of their income goes towards health costs, they also have

considerable purchasing power (assuming they have saved enough for retirement). Insurance industries will therefore need to become “elderly friendly”.

Some actions that have already been taken are the raising of retirement ages in certain countries and the expansion of anti-age-discrimination laws.

- More and more consumer experiences are directed at self-service.

Companies drive self-service offerings as it saves on operating expenses and improves efficiency. According to some this is in line with what consumers want – less interaction with human beings when they go “shopping”. The new slogan is that “business needs to get smarter when serving customers”. [Kiviat: 2008]

But do all consumers want this? And can this model work for insurance industries where the distribution channels are largely based on personal intermediation and advice? There is agreement that the cost of financial advice will get increasing attention eg. as-and-when commission developments in South Africa [Republic of South Africa: 2006].

The above global issues help to paint a picture of the changing landscape that will emerge locally.

Emerging issues

Sunter and Illbury’s identification of two key uncertainties locally is a good place to start looking for preferable strategies in addressing the insurance futures problem. They have highlighted the issue of competitiveness relative to the rest of the world; and cohesiveness of the nation [Sunter, Illbury :2008].

- Competitiveness relative to the rest of the world

Competition breeds innovation and value for money. This innovation and value should be directed to the second economy as well if the financial wellbeing of the poor is to be improved.

- Cohesiveness as a nation

Social cohesiveness as a nation is key. The recent xenophobic attacks on foreigners in South Africa clearly demonstrated the underlying grievances from a large section of the population. And this is where insurers can add value. If the insurance futures problem can be turned into a social-cohesion solution all role-players (including private industry) may benefit over the long-term.

The competitiveness of the private insurance industry and general social cohesion will be dependent on the inter-relationships of many possible factors. These dependencies are intricate, but can be explored for the micro-insurance industry by looking at the four scenarios described above. Since they are based on a series of scenarios with different economic, political and social climates constructed by Sunter and Illbury, they in effect form 'second generation' scenarios.

6.2 Insurance industry scenario's

The scenarios below are not just confined to the micro-insurance industry. They include the other market segments as well to provide the broader context that will, inter-alia, affect micro-insurance as well. Micro-insurance specific comments are highlighted as such.

The following driving forces of change in the broader industry are anticipated within each of Sunter's possible scenarios:

6.2.1 Long boom

This scenario assumes that South Africa achieves high levels of economic growth whilst continuing to establish itself as a regional powerhouse and global player.

It is not only South Africa that will continue this upward trend – the rest of Africa will catch on and may even pass South Africa as the mineral-rich countries attend to the needs of growth hungry India and China. Sustainable economic growth should therefore pick up for African countries overall [Zakaria: 2007].

Insurers with a footprint in Africa, China and India will benefit from increased levels of economic activity. Opportunities will exist to export financial services expertise (risk management, underwriting) and other (policy administration, product development) to these countries. Higher margins may be earned on business sold north of South Africa's borders if tax and regulatory environments remain beneficial in some countries and insurance markets start opening up in others.

The insurance industry will become an even more competitive environment with many insurers seeking to earn reasonable profit margins. This will lead to innovative product designs and service offerings, and further penetration of new markets such as micro-insurance. Margins may not necessarily remain high due to increased competition. There will be space for smaller niche insurers and underwriters to establish themselves in the micro-insurance space, seeing the market grow from the current 188 registered insurance companies in South Africa [Republic of South Africa: 2008c].

Insurers will be able to benefit by acting as underwriters to micro-insurance entities or entering into cell captive arrangements. They would, however, want to exploit opportunities in the micro-insurance market by taking on business risk directly via newly established distribution channels. They will not be willing to share the risks and profits/ losses. Local mergers and acquisitions activity will most likely increase, as insurers see the success of SMME's that have entered the micro-insurance space and want to achieve the scales necessary to further improve profitability in this space.

In order to encourage the extension of the formal market government will construct amnesty programmes to assist informal and illegal operators to register as licensed providers. This will support Financial Sector Charter developments and hopefully provide greater protection to the poorly educated and vulnerable of the micro-insurance market.

New products, beyond funeral cover, will be extended to low-income households in the micro-insurance market: legal insurance, personal accident insurance, household building and content insurance. All micro-insurance products will have short contract durations and low prudential risks associated with it. Government's social security net will probably provide basic disability cover to a wider population segment, but the need for additional disability cover and life cover will still exist.

Insurers would be able to leverage off a higher savings rate in SA in this scenario. A high savings rate is necessary for continued investment in economic growth. However, experience also shows that disposable income is often directed to the retail sector in economic growth phases. Insurers will need to influence the spending patterns of especially the black emerging middle class to establish a savings culture [Nieftagodien: 2007]. Asset deficits might take a few generations to remove.

Income inequality reduces in this scenario with more people becoming economically active, potentially bringing more people into the insurance loop. This scenario is probably the best to widen the reach of insurance to the

second economy since financial market stability will create a safer playing ground for insurers to penetrate this market. Higher personal income levels will lead to more disposable income being available, after allocations have been made to the National Social Security Scheme, to channel to private providers. A larger section of the population may also become economically active at this lower income level if unemployment rates drop.

Research, however, shows that the benefits of good economic growth are usually directed to those owning the capital and therefore the poor may not benefit from good economic growth [Schneider, Tufano: 2005]. But the chances of reducing the inequality of asset ownership between high- and low-income households, and among race groups in SA, are best in this scenario. And one would hope that a relatively more mature democracy by then would encourage the social mindset required to benefit not just the rich.

Consideration will need to be given to the extent to which first economy products subsidise second economy products, if at all. Shareholders may tolerate lower profit margins on micro-insurance products in this scenario if volumes are large enough. Higher margins on mainstream insurance products should already ensure good earnings potential and new technological developments would help to reduce costs per policy.

Levels of financial education in the low-income market should be much higher. Insurers will need to manage the transition from micro-insurance products to traditional insurance products carefully as levels of wealth increase. And they will need to attract customers away from retailers, banks and other lending institutions operating in the lower- and higher-income markets through innovative and value-added products.

There will be less need for insurance cover from the high-income end, as accumulated savings will provide sufficient protection in risk events. Savings- or investment products will attract more attention than risk products. Fierce competition can be expected here. The biggest threat will be from non-traditional investment houses and banks that will offer flexible products to consumers. If the insurance industry is not prepared to deliver flexible insurance-and investment products in this scenario, they will certainly lose ground against these non-insurers. Retaining customers in the traditional insurance space will require building good brand loyalty and offering superior investment returns and flexibility.

Policyholder activism will increase as a larger section of the population becomes financially educated and astute.

The current industry practice of self-regulation with its clear benefits of lower regulatory costs and improved market efficiencies will continue in this scenario. Prudential norms and practices to manage minimum solvency margins well will remain. Interference from regulators in this regard is unlikely if “insurance for all” is established. The micro-insurance market in particular may be self-regulated, in order to create the competitive playing field government is hoping for. Some form of regulatory reporting on micro-insurance products to protect customers is still envisaged.

As financial awareness grows, especially in middle and upper income classes, more and more of the consumer experience will be directed to the concept of “self-service” as a new distribution channel. Customers would want to access their policy information online in a similar fashion to current online banking practices. Companies will drive the self-service experience as it would save on operating expenses and improve efficiencies. Other Internet-based communication strategies will continue to develop and become cheaper as telecommunications costs in South Africa reduce.

A challenge for the industry that will remain is whether to remove complication in insurance products to serve the need of clients to manage financial affairs on a simple basis [Brown, Dall: 2005], or whether to attend to the greater need for tailored solutions from high-income individuals. Insurers will most likely offer relatively simpler product ranges overall, but with additional specialized services focused on niche customers.

Traditional brokers will have ridden the wave of changes from upfront to as-and-when commission implemented post 2009. Traditional broker models will prosper in this scenario as stable long-term income streams can be established from good sales volumes. Uncapped commission on micro-insurance products will not necessarily increase the cost of advice if there is sufficient competition in the market. The risk, however, does exist that it ultimately raises the cost of financial advice in this market.

New non-advice based sales channels, however, will be used to reach the lower income market in order to drive down costs. Group marketing will probably remain the preferred channel for the lower end of the market.

The online customer service model with limited personal contact will increasingly become the preferred purchasing channel for all retail products by the affluent in this scenario. Insurers will need to set up similar online communication structures to attract this market, otherwise they will lose this market to other financial providers.. Consumers will want to track fund value growth and performance online, by accessing portfolio details. Sufficient attention should be given to greater flexibility and proper communication when products are

bought online. So both on- and off-site verbal product information will need to be made available to customers. This holds for the micro-insurance space as well.

There will be a continued quest to expand service offerings and shed the “typical life insurer” label. Most large insurers would over the long-term be established as “wealth managers” in this scenario. They would most likely be referred to as “diversified financial services providers” and not as insurers any longer. But large providers will still need to ensure that their operational models allow for innovation and specialization within different business units, as the need for specialized services from different customer market segments will increase.

There may be a turn-around in the negative perceptions towards long-term insurers in South Africa. Most historical practices that have caused big upsets in the industry will have been addressed. Customers will appreciate the increasing level of financial- and management actions disclosures made, and also the increased levels of transparency. The educated poor will appreciate the efforts made by long-term insurers in widening their reach in the micro-insurance space. As financial astuteness increases, insurers will need to cater for these increased challenges from customers on the value proposition they receive.

Higher standards of living will lead to increased population longevity [Dixon: 2008]. Designing innovative pension products will become key. This will increase the costs of payments on annuity-type products and insurers would need to price appropriately for longevity to leverage off higher retirement savings in the economy as a whole. The alternative is to be weighted to those products where increased longevity offers relatively better margins, eg. whole-life assurance.

Improved longevity, coupled with increased fertility due to higher financial stability (probably a Western response), will lead to growth in the economically active population (ignoring a high HIV/AIDS infection rate before the start of the long-boom scenario). Declining fertility (due to less of a need to see children as future source of pension income – an African response), however, may well lead to a smaller economically active young population relative to elderly people.

Improved health and standards of living should reduce disease infection rates. Even HIV infected individuals may be economically active for longer due to better healthcare access. This in turn will also lead to greater retirement savings; but also a burden on pension-and healthcare systems to support the elderly for longer.

Contrary to international developments, the retirement age may be lowered in SA as a response to the unemployment issue and to provide more social security to the population as a political imperative. This could have negative consequences on the replacement ratio of retiring individuals.

Increased longevity and other demographic risks will see a bigger focus on sophisticated pricing and reserving practices [Brown: 2005].

Non-insurance competitors have strong balance sheets, exceptional financial flexibility, broad distribution and branding. In a long-boom scenario the threat from these companies will be much bigger as they will also benefit from increased savings pool and will surely target the same client base as insurers. It's all about entrenching the relationship with the customer. This probably remains the chief goal of insurers who now wish to be rather perceived as wealth managers than insurers.

Insurers will continue to lobby for more competitive company tax rates and lower tax on policyholders as the tax base increases. This will improve the attraction of life products above non-life products. A separate, more beneficial tax-regime for micro-insurance providers and customers will most likely be implemented. Special consideration will be given to the tax treatment for financial services co-operatives, friendly societies and illegal operators in the micro-insurance space.

Organizational complexity should be easier to manage with the education system delivering students of better caliber. Maths and science skills are key to supporting insurance operations. The supply of actuaries, accountants, IT specialists, brokers etc with higher levels of financial awareness will increase. Retaining these employees due to international mobility will be increasingly difficult and insurers will need to adapt to operational models where employees don't stay in one role or country for longer than three to five years.

6.2.2 Divided world

“us” vs. “them”

In the divided world scenario insurers will still benefit from high economic growth, but the opportunities to benefit from the advantages of globalization will be limited.

Relatively poorer technological advancement in South Africa compared to the rest of the world may make local insurers less attractive than their international counterparts. Raising capital may therefore become more expensive.

Increased measures of protectionism from African political leaders may inhibit opportunities for South African insurers to expand into Africa. Regulatory costs may be high in these countries.

Income inequality in South Africa will probably remain in this scenario with a burden on the fiscal basis to provide social security benefits. The resultant pressure on insurers to provide micro-insurance products to the lower income market will thus be heavier. Insurers stand the risk of poor relationships with government, unions and the general population if the balance between services and value to the higher-income groups and the low-income market isn't managed properly. This scenario may begin to see stronger action taken by unions and their members to obtain better value from private industry in South Africa in order to improve standards of living. These demands will continue to be directed to the insurance- and banking industries. This will increase political instability.

Social security reform will be driven even harder in this scenario than in the long-boom scenario. There will be less of a conciliatory approach from government's side to engage with insurers on the impact of proposed regulatory changes in the micro-insurance space. The political imperative to improve the financial wellbeing of the poor will be stronger than the need to maintain market efficiencies and promotion of free market ideals. This could begin to deter insurers from the micro-insurance space.

There is also a possibility that government may limit the granting of micro-insurance licenses primarily for BEE accredited SME development to put pressure on the long-term industry to support financial sector development. The simplified product structures and scaled regulatory requirements will reduce new entrants' dependency on established insurers.

It will remain an imperative to be seen as aligning with political aspirations of the country in order to survive stronger governmental intervention and increased financial awareness of consumers, even the poor. Having no means to wealth creation does not necessarily mean having a very poor financial education. School curriculums increasingly focus on financial awareness. Poor children now will become the middle-class consumers, and even yuppies, of the future. Those companies that can manage to gain this group's trust will win over the long-term. What this requires is supporting these individuals when their income is still relatively small, and hoping to gain their trust as preferred financial services provider as their relative wealth increases [Dixon: 2008].

The savings rate in the low-income segment will remain low, as these households will still be focused on attending to basic needs. There will, however, still be commercially viable opportunities eg funeral policies in this scenario, driven more by certain cultural forces than the level of disposable income.

There will be stronger regulatory intervention, with the waning of self-regulatory autonomies. Government will certainly look at implementing more policies to effect redistribution of wealth. If government begins to intervene in industry's domain it will surely result in higher regulatory costs and market inefficiencies. Some of these regulatory interventions for the micro-insurance market will serve a good purpose: protecting the interests of consumers; ensuring solvency and financial soundness of companies; ensuring stability and confidence in the financial markets. Whether the Financial Services Board can find cost-efficient and effective strategies to implement such regulations will remain to be seen.

Profit margins that can be earned on micro-insurance products will be under more pressure here. Margins from the higher-income products, however, will be under less pressure. Higher income groups will continue to invest due to good economic growth. It may, however, be with other investment companies rather than with insurers.

Pricing standards may be enforced on insurers to accommodate those in the second economy. Government will want to see the current suite of micro-insurance products, with specific standardizations targeted at the poor, expanded to widen the reach of insurance. This resultant standardization will offer ways to reduce costs and have other positive spin-offs. However, a greater focus on minimum solvency margins and required capital to ensure consumers are protected from adverse market changes in case of a hard-times scenario may negate some of these benefits. If the proposal from National Treasury that Financial Condition Reporting with its risk-based capital approach not be applied as the base capital for micro-insurers, the capital requirements will be less restrictive and make it easier for micro-insurers to manage their solvency [Republic of South Africa, 2008c].

This scenario may see the insurance industry split up into two segments: those insurers focusing on middle and upper classes only to protect their profit streams, living with the criticism from government and large sections of the population; and smaller, niche insurers that have entered the micro-insurance market. These will be specific underwriting entities, probably with dedicated micro-insurance licenses. The emergence of smaller insurers in this space will support government's aim of SMME development [Republic of South Africa: 2008c]. Their practices, however, will be under tremendous scrutiny from governments, unions and NGO's, even though government has indicated the intention that the micro-insurance market will not be regulated too heavily.

The alternative for large insurers would be greater involvement in cell-captive arrangements, where they share the risk of underwriting with retailers to sell micro-insurance products. Insurers can benefit from having in-house risk management expertise that they can sell to other micro-insurance providers, without having to invest large amounts in setting up their own distribution channels.

Internet-based communication strategies as model for customer service may still work for the micro-insurance market in this scenario, as an increasing footprint of online communication networks through cellphone banking for the poor becomes widespread. The greater challenge is getting the poor to buy the appropriate products in an environment where personal financial advice will diminish.

Extrapolating from current experience, telecommunications cost should come down – even in this scenario. This may make it more affordable for lower income households to own personal computers or to be educated using the Internet. There may also be opportunities to exploit this form of communication and marketing by for example placing self-help kiosks in “insurance cafes” where customers can search online for the best product to serve their needs. This may work in rural areas where telecommunications developments usually don’t reach the poor.

Insurers will have to rely on more local innovations to maintain market share of investment spending in SA and to drive down costs and to increase retention. Innovative payout options will be needed in order to retain funds that are paid either as death benefits or as lump-sum amounts.

Higher government spending on education should see micro-insurance customers having higher level of financial education than the current economically active group. They will tend to focus more on value-for-money and this will put insurers under pressure to improve their value offerings.

Relatively poorer investment performance due to global market constraints and regulatory protectionism will further put the spotlight on the value proposition offered to customers.

Average lifespan will be relatively shorter in this scenario than in the long-boom scenario: the improved population longevity will be offset by relatively higher mortality rates for the poor due to the current living standards not improving. The impact of HIV/AIDS, poor nutrition and limited access to healthcare services will leave a gap in the economically active population group. The potential customer base for the micro-

insurance market may therefore be smaller than in the long boom scenario, but still large enough to merit interest from private industry.

This will put strain on the remaining workforce to carry the economy. This may lead to higher stress induced illnesses and heart attacks in the working population – particularly amongst the higher income groups. This will affect claims rates for risk business.

There will be a burden on the pension system to support the elderly for longer and on the National Social Security Scheme to support the poor. The lower life expectancy of the poor may make it possible for government to further reduce the retirement age in this scenario since it will be able to support more people from the fiscal basis.

This scenario should see increased occurrences of widespread diseases breaking out due to poorer standards of living for a large section of the population, as mainly the rich will benefit from higher economic growth. There will be a bigger burden on healthcare- and government systems to support ill poor communities for longer. Special forms of combined risk-and savings products may come to the fore with an increased utilization of social organisations as distribution channels. The key focus in the micro-insurance market will be on family responsibility, financial planning responsibility and establishing a savings culture.

The risk of negative perceptions towards long-term insurers in South Africa will be higher in this scenario. Product complexities and the wide range of products available will leave consumers in analysis paralysis and increase the risk of mis-selling. Insurers will be less innovative as they will be less inclined to fund risky business ideas. Industry may lose some ground against more progressive non-insurance industries with simpler savings-and risk product ranges and that carry far less historical baggage.

The insurance industry may see some consolidation as large insurers buy smaller insurers that might get into trouble.

National savings will be relatively lower in this scenario due to government spending directed to needs of the poor. This will put more strain on the tax basis of insurers and individuals, leading to lower average levels of disposable income. Tax cuts to companies and individual insurance customers will therefore be unlikely in this scenario. The only consideration will be for customers and private providers in the micro-insurance space. The tax considerations mentioned in the long boom scenario to achieve a level playing field, even for the different types of micro-insurance providers, will probably be applied in this scenario as well without change.

Insurance underwriting does not earn consistent levels of profit. A variety of different premium rate structures, that appropriately reflect the costs of meeting risks and of fulfilling regulatory requirements, need to be developed to stabilise profit streams. It is furthermore dependent on geographical spread. Long-term insurers will continue to be less exposed to volatility in share prices than their short-term counterparts. But whereas short-term insurers can increase rates more often to lift margins (annually reviewable contracts), long-term insurers underwrite over a longer guaranteed period. The risks involved are therefore longer-ranged. Care needs to be taken in an environment where there will be less opportunity to diversify earnings across the globe.

Meeting tight reporting deadlines and increased levels of disclosures will be ongoing practice for insurers. Even though the world may be more fragmented than in the long boom scenario, there will be pressure by shareholders to automate processes, and make them more robust and flexible. Insurers will be forced to attract shareholder and market interest in this way, since negative perception against traditional insurers will persist. Other industries may look more attractive from a shareholder perspective.

Broker channels may suffer more in this environment as the high-income insurance market matures and there are limited opportunities to sell micro-insurance on a profitable basis.

6.2.3 Perfect storm

If bad political changes interfere with the normal recovery processes that come in the wake of a possible US recession [Sunter: 2008], the South African economy will take strain. Higher food, fuel and electricity prices will put even more pressure on government and business to survive an economic downturn.

A downturn in the global economy will adversely affect growth prospects for insurers in existing target markets. Insurers will feel a big squeeze on margins on current operations and will probably decline to enter new markets such as micro-insurance. Negative perceptions usually also threaten stability in financial markets, which in turn could lead to a bigger challenge to asset managers to produce reasonable returns on moneys invested. Investment-and other guarantees may start biting, eating into the reserves of insurers and possibly threatening solvency. The micro-insurance market, however, may be less affected since the simple product structures will probably not contain investment guarantees and capital requirements will be lower. Assets backing micro-insurance business will most likely also be limited to low-risk liquid instruments negating the impact of volatile investment markets.

The risk of political instability due to the poor management of government functions will be higher. The current tri-partite alliance may have split and the union leaders from the left increasingly involved in government. This will lead to poor sentiment from the international investor community and will lead to outflows of capital.

Due to the high cost of regulation of insurance business, unlicensed insurers may increase non-advice based intermediation activities to offset depressed margins in the micro-insurance market. This could lead to the exploitation of a large section of financially illiterate low-income households and increase reputational damage to the whole insurance industry. Government's ideal to rid the micro-insurance market of illegal and abusive practices may not be realized.

There is a threat that regulations can turn into controls that are aimed at micro-managing the industry and interfering with market efficiencies

Government may force insurers through stronger regulation to enter the micro-insurance market. But its own initiatives may backfire as enforced savings through the proposed national retirement fund may lead to mass revolt from the poor who will not be able to meet their basic needs. This scenario may see the micro-insurance market shrinking from its current size.

The impact of HIV/AIDS will be worse in this scenario due to very low standards of living of the poor. This will lead to an even smaller economically active population to carry the economy. The economically active numbers expected to come through from the black middle class may not materialize. Lower new business sales and lower profit margins will be a trademark of the insurance industry.

High crime rates will lead to further instability, higher short-term insurance claims rates, premium increases on reinsurance products and ultimately higher costs for the long-term insurance industry. The scope to pass on increased costs to customers will be limited due to the long-term contractual nature of insurance products. The micro-insurance market, however, where products are expected to be annually reviewable [Republic of South Africa: 2008c] may offer more scope to pass on such costs. It will be limited though by the higher risk of policy cancellations in this market. There will also be strain on insurers' reserves to pay out the relatively higher incidence- and levels of claims.

Increased policy cancellations and lapses will put strain on customer service divisions. A combination of the above factors may result in bad publicity for the industry and press coverage will increase reputational damage risk to an injured industry.

6.2.4 Hard times

Sunter and Illbury placed their bets on this scenario for being the most likely. In it, a US recession affects the whole world, globalisation remains both a threatening and enticing force and South Africa experiences low economic growth. South Africa will not escape the impact of a US recession, even though it has become less dependent on the US economy in recent years.

New development models will be less attractive than in the long boom scenario. Export-dependent China may grow at a much slower rate due to its big exposure to the USA and its dependency on African mineral resources. Africa too may therefore grow at a slower pace. This will limit opportunities to enter untapped insurance markets in the rest of Africa.

This scenario is expected by Sunter to be short lived. Recent political instability, higher electricity prices, the soaring cost of food and fuel, and negative regional sentiment, however, may prolong this scenario for South Africa.

Due to the low economic growth South Africa will become less competitive than other emerging market peers in this scenario. The cost of technological imports will become too big to sustain.

Only those insurers that have sufficient capital to support them through such a downturn will win from a recovery afterwards. Sufficient shareholder capital is needed to survive the depth of an economic crisis. This could bring opportunities for takeovers and mergers action in the smaller insurer space. It will lead to the sifting out of smaller companies leading to larger insurer conglomerates stretching their market influence. The number of competitors in this space will not be as big as in the long boom or divided world scenarios. The risks of under-cutting prices will therefore be lower.

There will, however, be pressure on profit margins in the insurance industry as retention worsens and clients spend a bigger proportion of disposable income on credit servicing and other survival goods. The micro-insurance market in particular may not be commercially attractive in this scenario due to low-income households directing most of their spend to the rising cost of food and fuel. Even the funeral insurance industry

may take strain in this scenario, as customers will be willing to sacrifice on cultural preferences in order to meet day-to-day necessities. Pressure on disposable income is mostly felt by the lower-income market that is the most vulnerable to economic hardship.

Social retirement reform will remain a major challenge in this scenario with a big burden on government to support the poor during hard times. Income inequality will worsen from current levels.

Opportunities to gain from an emerging black middle class will weaken substantially in this scenario. The transition rate to the middle class will be much slower and micro-insurance will remain the only alternative to reach intended levels of insurance cover for a large section of the population. It may, however, require some subsidy from the higher-income markets.

Sunter further expects that the country will experience moderate political stability, but with surges of political threats from the far left. The threat of nationalization of parts of the insurance industry will remain in this scenario, as government will have to address the needs of the poor and improve their financial wellbeing in a cycle of economic downturn.

What may increase is the amount of public-private partnerships. This will be a key dependency in the hard times scenario. Government will not have all the funds it will require to meet social security needs. It will depend on the private industry's footprint in rural areas and informal settlements to distribute grants. These increased volumes could help private industry in meeting fixed costs in running its distribution channels efficiently if it chooses to participate in the micro-insurance market.

Living standards will be poorer than in the divided world scenario and many South Africans will not survive to retirement age, or will become disabled or economically inactive.

Healthcare costs will continue to soar in this scenario due to poor claims experience. Many insurers may exit the medical scheme industry as a result and consolidation of schemes will be widespread practice.

Replacing disabled customers' income offers important financial security. Whether these should be offered as stand-alone benefits by the private industry in the micro-insurance space, or as part of benefits offered under a national retirement fund, needs to be researched properly as it might not be commercially viable in this scenario. Regardless of the scenario, the focus needs to be on the cost-effective provision of risk benefits in the micro-insurance market. Few insurers may therefore successfully tap into the micro-insurance market.

What probably will become standard practice by insurers is a focus on investing premium income in assets that will ultimately benefit the communities from which those premiums were paid. This could, for example, mean investing in shopping malls around those communities to stimulate economic growth. Such forms of socially responsible investing will only be explored if they are commercially attractive to insurers, no matter how great the need is to widen the spread of insurance and wealth building in the country.

Complexity framework

The above scenarios highlight the intricacies involved in exploring the insurance futures problem and how important an understanding of the inter-relationships between various role-players and factors influencing the micro-insurance market is.

The value of the scenarios lies in the process of deriving the alternative futures, as well as understanding the possible implications thereof.

Table 5 below revisits Cilliers' characteristics of complex social systems as applied to the insurance futures problem. It is an example of how complexity theory can be developed into a framework for mapping a particular futures scenario. In this instance it is mapped for the hard times scenario, but can be copied for any other scenario. It should therefore assist industry-leaders in managing the process of deriving alternative futures.

Table 5: Complexity framework for a micro-insurance futures discussion based on hard times scenario

	Past	Present	Future
1. Large number of elements, difficult to quantify.	Few large insurers dominating local insurance industry Large population segment with no insurance cover at all and no guaranteed income streams	Large number of registered insurers in long-term space; many illegal providers in micro-insurance space Limited customer bases in low-income market; healthy informal economy income streams	New competitors entering micro-insurance market eg cell captives, SMME's; how will illegal providers be dealt with? LSM 1-5 penetration must be increased against backdrop of increasing income inequality
2. Large number of elements necessary and interaction dynamic.	Competition from within insurance space drives innovation Focus on price	Serious competition for disposable income from outside traditional insurance space - alternative investment providers Focus on price and value-for-money	Financial Sector Charter initiatives to establish more competitors in traditional- and micro space; insurance innovation boom Focus on price, value-for-money and social cohesion
3. Rich interaction among elements.	Government social security net has limited spread Poor standards of living for low income households	Government social security spend has good spread Improved access to water, sanitation, housing, jobs etc increases standards of living	Private industry and government working together to spread social security to the poor Increased longevity and standards of living for the rich; poorer longevity and health for the poor if economic downturn sticks
4. Interactions are non-linear	Insurance products are popular at almost all income levels	Insurance needs do not necessarily grow in line with increasing levels of wealth	Emerging black middle class may choose consumption spending on retail middle class goods above savings culture and insurance spend
5. Interactions have short range, but wide influence.	Beneficial tax regime makes insurance products popular for high- and middle income market	Tight regulatory controls and demarcation of insurance- and other banking products makes insurance business less attractive and more costly	A separate tax regime for micro-insurance providers that incorporates a review of the tax basis for friendly societies and other financial services co-operatives.
6. Recurrency (varying degrees and methods of feedback)	Lower income-inequality leads to more standard mortality rates across the population	HIV/AIDS has major impact on mortality rates; demographics differ widely in population	Improved living standards of wealthy improves longevity; poorer living standards worsen it for low-income groups; prevalence of other diseases
7. Interaction with environment.	Private industry serving mostly first economy	Limited involvement of private industry in micro-insurance space	Continued limited involvement of private industry in micro-insurance
8. Dependency on constant energy to be maintained.	Micro-insurance market mostly served by providers in the funeral space harnessing customers' cultural needs for proper funerals Low incomes of the poor generally make micro-insurance unviable	Continued period of economic growth and social development has made a regulated micro-insurance market attractive Funeral cover insurance penetration is 33% of all LSM 1-5 adults; commercial viability emerged	Low economic growth limits micro-insurance penetration Certain benefits may prove to be viable in micro-insurance space if income levels increase
9. Evolution over time.	Small & simple product range in market Unregulated funeral products in micro space	Wide & complex product ranges in market Regulated funeral products in micro space	Calls for simpler product ranges – cheaper to manage A range of funeral products, income protection and other disability products
10. Responsiveness to information that is locally available	Limited interaction between government, insurers and organizations supporting poor communities	Government and private industry engaging one another on social security; poorer households more vocal in raising needs and concerns	Information sharing among various role players better managed, but does not necessarily lead to improved outcomes for all.

7. Conclusion

South African insurers are faced with the challenge of widening the reach of insurance to those in the second economy. The market is currently relatively untapped and government has an expectation that private industry will partner with it to improve the financial wellbeing of the poor by providing value products and services.

Insurers will need to respond to this call, but will need to find creative ways of penetrating this market in a commercially viable way. New thinking is required to understand and explore the various needs of all the role-players and to find win-win solutions.

The complex dynamics of insurance business make the penetration of the micro-insurance market tough. The range of demographic-, organisational- and business factors to consider, and their inter-dependencies, are difficult to analyse and project. These need to be understood properly if solutions to the insurance futures problem are sought.

The insurance industry needs to create its future, not just predict what it will be. This requires strategic action to help shape a preferred future for all parties involved. Constructive dialogue is necessary. Those insurers that can demonstrate their strategy of building the financial- and social welfare of the nation will prosper. Those who don't might be judged harshly by future generations.

If our analysis of the future is to be more rigorous, as a profession we would need to put more emphasis on the various qualitative research methods available to project the future.

This paper explored solutions for the insurance futures problem using futures methodologies.

Complexity theory offers a useful methodology for describing the micro-insurance market as a social system. It highlights the need to focus on the inter-relationships between all roleplayers and the differing perspectives. If this complexity and multi-dimensionality can be properly managed a micro-insurance space could develop in which the whole is greater than the sum of the individual role-player contributions.

Scenario planning aids in understanding of possible and probable futures. The long boom scenario is most promising for insurers to enter the micro-insurance market. But if one is to accept the hard times scenario as most probable, and the national imperative of insuring the un-insured of the second economy, all role players

would need to work together very hard to effectively widen the social security net. Few insurers will be able to harness opportunities in the micro-insurance space successfully.

Only if the above issues are tackled with purpose may the industry remain globally competitive, whilst widening the micro-insurance net to some extent in a commercially viable way. It will require industry leaders to advocate the benefits of social cohesion, and take the lead in developing fair micro-insurance solutions.

Whatever strategic response is decided upon, may the approach be in tune with the changing times.

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