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ZhongAn's Micropremium Model: The Future of Insurance?

With scale, Chinese online insurer ZhongAn has created a market where there was none before.

Traditionally, nonlife insurance has focused on major but infrequent events, such as a home fire or car accident. By paying an annual premium, customers get peace of mind but they forego insurance when premiums are too high. Chinese online insurer ZhongAn has pioneered a very different vision of nonlife risks and insurance. It observed that people routinely encounter minor frustrations or "pain points", ranging from train and airport delays, mobile phone screen cracks, to events cancelled due to bad weather. While one can live with these risks, ZhongAn realised that at scale, many of these pain points could be covered by an insurance policy, and that the cost would be minor if each event was priced separately.

ZhongAn's most popular product has been its shipping return policy. In China, buyers are often concerned about the quality of the products they purchase online. To address this, ZhongAn developed a policy for buyers to cover return shipping costs and a policy for sellers to cover the shipping costs of a replacement product. The cost is a mere 0.15-3.3 yuan (US$0.02-0.53) per policy for sellers and 0.2-9.9 yuan (US$0.03-1.58) per policy for buyers.

Given the ubiquity of pain points in consumers' lives, insurance can become a repeat-purchase product rather than a one-off annual expense. In 2016, the average customer bought 10.3 policies from ZhongAn. Most traditional insurers sell fewer than two policies per year to the same person.

ZhongAn set out to de-risk multiple, seemingly insignificant events. Instead of charging one annual lump sum covering all such events, it devised policies tied to each event. Premiums are so low that they can be paid from pocket money, hence the name "pocket insurance".

Billions of transactions allow ZhongAn to collect extensive data on customer behaviour. By learning what customers do in particular situations, the company can offer customised products. By the end of 2017, the company had close to 300 insurance products that could be customised into thousands of insurance solutions. ZhongAn typically takes less than a month to develop a new product, which is about five times faster than a traditional insurance company. This "fast insurance" product development and sales is reminiscent of the "fast fashion" model of Zara and H&M.

A growth boosted by the leading ecosystems

Scale is crucial: Micropremiums only become significant if the volume of transactions is large enough. ZhongAn was able to scale up quickly by embedding itself in the ecosystems of its founding investors Alibaba (e-commerce), Ping An (insurance) and Tencent (social platforms including

WeChat).

There is a similarity between ZhongAn's business model and Google's original web search and transaction model. Google's AdWords and AdSense programmes allowed countless small and medium businesses to advertise their products and services to millions of customers at a very small cost, thus enabling transactions. Similarly, ZhongAn's business model has enabled millions of transactions between buyers and suppliers by de-risking the transactions, also at a very small cost. This creates benefits for buyers and sellers, and thus for the ecosystem, which in turns draws in more buyers and sellers, thereby accelerating the growth of the ecosystem…and that of ZhongAn.

How successful is ZhongAn?

The premium growth of the company has been nothing less than spectacular. Premiums have risen from 794 million yuan in 2014, to 5957 million yuan by the end of 2017. ZhongAn has been growing in many insurance segments, including consumer electronics, consumer finance, travel, health and automobile. Launched in 2013, the company currently has a market cap of over **$US10 billion** on the Hong Kong Stock Exchange, where it started trading in late September 2017, and it has sold over **7 billion policies** to 490 million customers.

However, its fast growth is associated with a high expense ratio (administration, sales and distribution, etc. to gross premiums underwritten), which stood at 76.5 percent in June 2017. As a comparison, Admiral, the leading low-cost nonlife insurer in the United Kingdom, reported an expense ratio of 16 percent in 2016.

Part of the issue may be the very hefty consulting fees and service charges ZhongAn pays to its founding partners. The fees are for delivered services (e.g. insurance competency provided by Ping An) and traffic generated by the founding partners' websites. In total, the fees represented about 30 percent of gross premiums underwritten in 2016. If ZhongAn could eliminate these charges, its expense ratio would be in the 30 to 40 percent range.

With a lower expense ratio, ZhongAn would have a very good chance of becoming more profitable than traditional insurance companies, perhaps even in the same range as Expedia, Booking.com, Google and other internet giants. It is pursuing this direction by diversifying its ecosystems, benefiting from economies of scale as it continues to grow and expanding into insurance lines with lower expense ratios such as health.

Impact on the insurance industry

Big insurers should watch out. As ZhongAn gains more traction in the pocket insurance market and diversifies across insurance product lines and ecosystems, it is likely to continue to innovate and create new products in the larger segments of the insurance industry. The car insurance market is one such segment. ZhongAn has already pioneered a **platform** integrating some car manufacturers, online dealers, after-sales services, ride-hailing services, car financing and, of course, car insurance. The customer can find personalised "scenario-based" offers, including pay-as-you-go insurance. The company is using machine learning and analytics tools to improve the customer shopping experience, and customers are responding. ZhongAn's **car insurance premiums** in January 2018 were impressive, amounting to roughly 70 percent of the premiums it earned for that segment in the whole of 2017.

ZhongAn is still a small player in the insurance world. But 20 years ago, so were Expedia and Booking.com compared to travel giants the likes of American Express, Carlson Wagonlit and Thomas Cook. ZhongAn combines a number of key strengths:

1. Technological prowess based on data analytics, artificial intelligence, dynamic pricing and cloud-based computing;
2. An understanding of the customer's digital purchase decision, across many markets;
3. Insights into critical mass dynamics and strategy; and
4. A CEO on a mission to redefine insurance.

No room for complacency

When innovation (or disruption) meets critical mass dynamics, the pace of change can become exponential, as we have seen in the travel industry. Of course, many promising start-ups do not make it because of management mistakes, a weak business model or changing market conditions. The roller-coaster success and failure of peer-to-peer lender **Lending Club** in the United States is a salient reminder. Its dependence on institutional investors proved a major handicap when these investors left, causing a collapse in its stock price and outlook. If ZhongAn fails to reduce its dependence on its founding partners, its spectacular success could be threatened if one of them decides to severe ties or become a direct competitor.

However, the business model of ZhongAn has many elements that are sustainable and replicable in other geographic markets. Germany's **massUp** is seeking to develop a similar model in its domestic market.

ZhongAn would not be where it is without the massive power and support of Alibaba, Tencent and

Ping An. However, other combinations of partner companies could also enable disruption. Incumbents need to think beyond their comfort zone and analyse how they can be part of an industry's redefinition. Digital efficiency upgrades are obvious requirements. Growth innovation strategies are tougher, but possible, and often lead to a much bigger payoff.

This is the third of a three-article series on digital disruption in the insurance industry. The **first article** discusses the extent of disruption in the insurance industry, the drivers, and the opportunities and challenges for new entrants and incumbents. The **second article** features Cuvva, a London-based start-up that makes it easier for drivers to buy pay-as-you-go insurance.

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