

Profitability Gains from Bancassurance: A Case Study of State Bank of India

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Abstract

The present paper is an attempt to measure profitability gains from bancassurance by taking a case study of State Bank of India (SBI). The CAMEL indicator approach has been used to assess the impact of bancassurance on the financial performance of SBI. The analysis reveals that the bancassurance has improved almost all components of CAMEL model significantly except four indicators namely, Capital Adequacy Ratio (CRAR), Non-interest income (NII), Return-on-Assets (ROA) and Return-on-Equity (ROE)

Keyword: Bancassurance, Profitability, SBI

Introduction

A healthy banking system is essential for any economy striving to achieve good growth and yet remain stable in an increasingly global business environment. The Indian banking system, with one of the largest banking networks in the world, has witnessed a series of reforms over the past few years like the deregulation of interest rates, dilution of the government stake in public sector banks (PSBs), and the increased participation of private sector banks. All the private entities plunged almost simultaneously with a very little spacing of time and the entire banking sector was exposed to stiff competition. In such a competitive environment, banks were under pressure to find out something that can secure their survival. So the banks stepped into new areas and started offering innovative products, viz., merchant banking, lease and term finance, capital market/ equity market related activities, hire purchase, real estate finance and so on. Thus, present day

banks have become far more diversified than ever before. Therefore, their entrance into insurance business is only a natural corollary and is fully justified too, as 'insurance' is another financial service required and desired by the bank's customers. Moreover bancassurance income can be used to partly offset the interest reduction in a competitive lending environment.

"Bancassurance" is a term coined by combining two words bank and insurance, connotes distribution of insurance products through banking channels. It is a provision of insurance and banking products through a common distribution channel to a common client base. It is also defined as "the ownership and channel integration of a bank and insurance carrier, with the aim being to cross sell insurance and investment products through the bank distribution network". Bancassurance encompasses terms such as '*Allfinanz*' (in German), '*Integrated financial services*' and '*Assurebanking*' which describe a package of financial services that can fulfill both banking and insurance needs at the same time.

Reasons for Banks for Entering into Bancassurance

In the post-reforms, the financial sector has number of players of both domestic and foreign nature and the dividing line between the banks and non-banking financial institutions' activities had considerably thinned down. Overlapping in one another's functions/ areas has become more common than exception. The direct upshot of these developments led to intensive competition in the banking sector and which in turn had a strong bearing on the banks' net interest margin Karunagaran (2007). In fact the emerging scenario is likely to bring down the

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banks' spread even thinner. Table 1 shows that the spread ratio has considerably come down cutting across all the banking groups.

Table 1: Ratio of Net Interest Margin or Interest spread to Total Assets in Different Bank Groups of India

Banks	Years	
	2001	2010
SBI & its Associates	3.01	2.36
Nationalized Commercial Banks	3.08	2.28
Foreign Banks	4.01	3.97
Total banking System	3.08	2.55

*Note: includes all Scheduled Commercial banks

*Source: Various Issues of RBI Bulletin

For the banking system (all scheduled commercial banks) spread ratio decelerated from 3.01 percent at end of March 2001 to 2.36 percent at end of March 2010. In case of nationalized commercial banks spread ratio decelerated from 3.08 percent at end of March 2001 to 2.28 percent at end of March 2010. Foreign banks are not an exception to it, they registered a decline in spread ratio from 4.01 percent at the end of March 2001 to 3.97 percent at the end of March 2010. Therefore banks were compelled to be constantly on the lookout for a stable alternate source of earnings in the form of non-traditional and fee based sources of incomes. In addition to it, there are many factors like level of non-performing assets, liberalization, widening of financial services, problem of overstaffing, strong image, customer retention, optimization of infrastructure costs, need to satisfy the risk needs of the customers, service synergies, convenience of convergence in built which were considered to be strong determinants for banks for entering into insurance business.

Scope of Bancassurance in India

Bancassurance is a long standing dream of offering a seamless service of banking, life and non-life insurance products. India, being the one of the most populous countries of the world has an envious chain of bank branches as a life line of its financial systems. Banks can straightway leverage their existing capabilities in terms of database and face to face contact to market insurance products to generate some income for themselves, which hitherto was not thought of. Bancassurance will help in exploiting the

synergy in the context of India, having the largest banking network coupled with lower insurance penetration and lower insurance density. Public and private sector banks together have a network of over 80,000 branches- 14000 metro, 16000 urban, 18000 semi-urban and 32000 rural branches. They can see value in insurance business due to complementarity of products and can generate fee income from the distribution of insurance products. It is a huge banking infrastructure and among the best banking network in the world. Currently, there are 17 banks with shareholding in insurance companies and almost all banks are acting as corporate agents for insurance companies. Clearly, it is something that would enable the insurance companies to capture the vast untapped population. In simple words, it is aptly put that bancassurance has promised to combine insurance companies competitive edge in the production of insurance products with the banks' edge in their distribution through their vast retail networks (Knight, 2006).

The total premium collected through bancassurance in 2009-10 was Rs.21947 crore, 7.31 % the total premium income of life and non-life insurance sectors put together. Bancassurance have resulted in cost saving of around 21% and a revenue gain of 5% as the insurers had ready access to the database of the banks. With the database of the banks, insurers have opportunity to cross sell insurance products to each segment of banks' customer base. Single premium structured investment products to high net worth customers, unit linked plans to salaried and endowment policies for middle income segment can be easily sold and can prove to be a gold mine.

Review of Literature

A plenty of research is available on the topic of bancassurance. Some of the studies explored the aspects such as the model suitability for a given country with its economic, cultural and social ramifications interacting on each other. Legislative hurdles and the mindset of the persons involved in this activity have dominated the study and the literature on the Bancassurance. The concept, framework and implementation issues regarding bancassurance have been discussed in detail by Aggarwal (2004). However, the study of Flur *et al.* (1997) explored the issue whether banks can become the new channel to sale insurance or not.

Rumeer (2002) explored the factors that make bancassurance possible. The growth of bancassurance

in Asia has been studied by Swiss Re (2002), whereas, Krishnamurthy (2003), Anand and Murugaiah (2006), Pejawar (2008) and Neelamegam (2008) examined the blueprints of the growth of bancassurance in India. The policy issues about the growth of bancassurance have been addressed in the research endeavour of Malpani (2003), whereas, the analysis of Irala *et al.* (2004), Chaudhary (2004), Karunagaren (2006) and Mathur (2010) discussed the challenges to the growth of bancassurance in India. However, to the best of our knowledge, no attempt has been made that explores the financial performance of banks providing Bancassurance services. The present study is an attempt in this direction and explores some issues like the present status of bancassurance in India and its effectiveness on the indicators of financial performance of SBI.

Database and Methodology

The study has been undertaken for a period of ten years from FY 1995-96 to FY 2005-06. The years from 1995-96 to 1999-2000 are designated as the pre-bancassurance period and 2000-01 to 2005-06 as the post-bancassurance period. In order to analyse profitability gains from bancassurance to State Bank of India, CAMEL, a recognised model for measuring the financial performance of banks, is used. Year-on-year growth rates have also been computed for the select financial indicators. To undertake the comparison of financial performance of SBI, the average of each indicator has been compared over two sub periods using *t-test* statistics with and without equal variances.

Nature and Sources of Data

The study is mainly based on secondary data obtained about the State Bank of India, a public sector giant in Indian banking industry that has been taken as a sample bank for the study. Data relating to various indicators have been taken from annual reports of SBI and from Ace Equity database.

Objectives

The paper carries the following major objectives: i) to compare the financial performance of State Bank of India after entering into insurance; and ii) to offer suggestive measures and policy implications. The relevance of selecting SBI as the target bank stems from the facts that

i) the SBI is the oldest existing bank in India established as Bank of Bengal in 1806; ii) apart from providing normal banking services, SBI was the first bank to enter in the insurance market when the bank announced a joint venture partnership with Cardiff SA (the insurance arm of BNP Paribas); and iii) even though the regulators have said that the banks would not (generally) be allowed to hold more than 50 percent of an insurance company, the SBI was allowed to do so.

Methodology of CAMEL Model

To judge the financial viability of banks, the Reserve Bank of India has introduced a rating methodology known as CAMEL (Capital adequacy, Asset quality, Management performance, earning performance, Liquidity Model). The CAMEL model can be implemented by making use of publically available accounting data. Table 2 presents the financial indicators (taken for this study) for each of these selected modules and its expected effects on the likelihood of imp of improvements of bank's performance. A brief description of all these ratios has been given as follows:

Table 2: Financial Indicators and their Expected Effects

<i>Financial Indicators</i>	<i>Expected effect on Performance</i>
Capital Adequacy and Solvency	
Capital Adequacy Ratio	Increase
Asset Quality	
Return on Assets (ROA)	Increase
Non-performing Assets (as % to Net advances)	Decrease
Management Performance	
Business Per Employee	Increase
Profits Per Employee	Increase
Operating Cost as % to net income	Decrease
Non-fund income as % to total income	Increase
Earning Performance	
Earnings Per share	Increase
Return on Equity	Increase

Capital Adequacy Ratio (CAR): Capital Adequacy Ratios are measure of the amount of bank's capital expressed as a percentage of risk weighted credit exposures. As per the RBI guidelines for banks to enter into the insurance sector, the CAR of the bank should not be less than 10 percent. Hence, the analysis of the ratio during two periods (taken for the study) becomes important.

Return-on-Assets (ROA): This ratio is calculated to judge the productivity of the banks. In bancassurance, since the banks will be able to generate a fixed and additional source of income with existing asset structure of the banks, this ratio is hypothesised to be improved from pre to post bancassurance period.

Non-Performing Assets (NPA) as percentage to Net advances: Banks are required to reduce their NPAs to a reasonable level, as a precondition to enter into bancassurance. And moreover, when insurance products will be used as collateral to secure bank advances and loans, banks would be able to control their NPAs. Hence this ratio is hypothesized to decrease over the two periods.

Non-interest income as percentage to Operating profit (NII): Banks will be able to generate new, fixed additional and risk free source of income by entering into insurance so this ratio is hypothesized to improve between two periods.

Business Per Employee (BPE): This ratio is used to find out the productivity of employees. It is the other benefit associated with Bancassurance. The bank can be able to earn income through Bancassurance business by using its existing employee.

Profit Per Employee (PPE): Same as that with the ratio mentioned above i.e. Business per employee, this ratio is also hypothesized to increase over the two periods.

Operating Expense to Total Income Ratio (OPC): Since banks will be able to enjoy, economies of scale and economies of scope, so this ratio is also hypothesized to increase.

Return on Equity and Earning Per Share (ROE & EPS): These two ratios are hypothesized to increase as bancassurance will contribute to the non-fund income of the banks and thus to profitability that will ultimately belong to the share holders.

Empirical Evidences

Using the aforementioned CAMEL model, the performance of SBI has been evaluated through testing the significance in the change of the average values of the variables of CAMEL model. Simple *t-test* for two independent samples has been used to test the significance of the difference between pre-bancassurance and post-

bancassurance values. Table 4 provides the detailed evaluation of CAMEL model over the study period under evaluation. It is worth mentioning here that the performance of SBI in Bancassurance is not in its infancy rather it is in developing stage. The bank has achieved almost all of the advantages of cross selling through bancassurance. The analysis of CAMEL model reveals the following facts:

1. The Capital Adequacy Ratio (CARR) has been found to be satisfactory, as it has been above the prescribed norms of RBI. However, the change in CARR is statistically insignificant given that the *p-value* of *t-statistics* is above the three levels of significance. The finding thus, represents that the introduction of bancassurance though has improved CARR, the observed improvement is statistically insignificant;
2. The prescribed norm for bancassurance by RBI is that the reasonable level of non-performing assets. Table 4 indicates that on an average the NPAs as a percentage of net advances have decreased from 5.4 percent to 4.4 percent. The decline is statistically significant too representing that the bancassurance helps to cover the losses of banks through NPAs. The banks through forced selling of insurance products insure the loans against NPAs. Therefore, the policy of insuring the assets of banks has improved the recovery of Assets and NPAs of SBI have declined by significant amount during the post-bancassurance era;
3. As the bancassurance revenue leads to an increase in the non-interest income, Table 4 shows that non-interest income as a contribution of operating profit has increased from 1.228 to 1.592 percent, respectively for two periods under study. However, the observed increase is statistically insignificant. Though, the SBI has earned 223.86 Crores, 221.06 Crores and 168.46 Crores as bancassurance commission in the year 2009-10, 2010-11 and 2011-12, respectively, it fails to bring a significant improvement in non-interest income;
4. The best opportunity for banks, which undertakes bancassurance operation, is that they can increase their return on assets. From Table 4, it is amply clear that ROA for SBI, on an average, has increased from 0.59 to 0.80 percent from pre-bancassurance to

Table 3: Comparison of CAMEL Parameters of SBI over Pre- and Post-bancassurance Periods

POST-BANCASSURANCE PERIOD (2000-01 to 2004-05)									
Years	CAR	NPA	NII	ROA	PPE	BPE	EPS	ROE	OPC
2004-05	12.45	2.65	1.69	0.99	0.02	2.43	81.79	19.43	2.19
2003-04	13.53	3.48	1.99	0.94	0.02	2.11	69.94	19.67	2.27
2002-03	13.50	4.5	1.68	0.86	0.02	1.91	59	19.15	2.11
2001-02	13.35	5.63	1.26	0.73	0.01	1.73	46.2	16.95	2.07
2000-01	12.79	6.03	1.34	0.5	0.01	1.37	30.48	12.53	2.63
Average	13.12	4.458	1.592	0.804	0.016	1.91	57.482	17.546	2.254
PRE-BANCASSURANCE PERIOD (1995-96 to 1999-2000)									
Years	CAR	NPA	NII	ROA	PPE	BPE	EPS	ROE	OPC
1999-2000	11.49	6.01	1.31	0.75	0.01	1.11	38.98	18.2	2.41
1998-99	12.51	7.18	1.48	0.46	0	0.94	19.53	10.27	2.65
1997-98	14.58	6.07	1.57	1.04	0.01	0.75	35.36	21.17	2.63
1996-97	12.17	7.3	1.54	0.88	0.01	1.53	25.64	20.08	2.94
1995-96	11.60	6.64	1.55	0.6	0	1.54	17.54	16.32	3.09
Average	12.47	5.438	1.228	0.596	0.004	0.952	19.614	13.568	2.262
F-Statistics	6.782** (0.045)	0.179* (0.062)	0.129** (0.036)	1.346 (0.39)	1 (0.5)	0.787 (0.411)	0.224* (0.088)	2.04 0.252	1.455 (0.363)
t-Statistics	-1.091 (0.162)	3.1625** (0.012)	-0.726 (0.25)	-0.431 (0.338)	-2.88*** (0.010)	-3.09*** (0.007)	-3.034** (0.011)	-0.144 (0.444)	3.125*** (0.007)
Expected Effect	Significant Improvement	Significant Decline	Significant Improvement	Significant Improvement	Significant Improvement	Significant Improvement	Significant Improvement	Significant Improvement	Significant Decline
Observed Effect	Insignificant Improvement	Significant Decline	Insignificant Improvement	Insignificant Improvement	Significant Improvement	Significant Improvement	Significant Improvement	Insignificant Improvement	Significant Decline

Notes: i) Values in parenthesis of type () are p-values; ii) ***, ** and * reflect that value is significant at 1, 5 and 10 percent levels of significance; and iii) negative value of *t-statistics* represent higher average in Post Bancassurance period and *vice-versa*.

*Source: Author's Calculations

post-bancassurance period, respectively. Similarly, Return on Equity (ROE), on an average, has increased from 13.568 to 17.546 percent, respectively over two periods under evaluation. The statistical testing reveals that though improvement has been observed in ROA and ROE, the improvement is statistically insignificant in both of these cases;

- The other benefit of bancassurance is that, banks can increase its business per employee and profits per employee by redeploying its existing human force for selling insurance. Table 4 indicates that business per employee and profits per employee on an average have increased from 0.952 and 0.004 to 1.91 and 0.016 percent, respectively from pre-bancassurance to post-bancassurance period. The observed im-

provements in both variables are statistically significant as both of these variables are statistically significant at 1 percent level of significance;

- Bancassurance will lead to reduction in expenses of the banks as it can have the opportunity to avail economies of scale. From Table 4, it may clearly be inferred that operating expenses on an average has reduced from 2.262 percent to 2.254 percent, respectively. The decline in operating cost is also statistically significant at 1 percent level of significance.
- The variable earning per share (EPS) is not directly related with Bancassurance. But the result of any reforms in any industry will indirectly aim to improve its earnings per share. In this sense it is essential to have a look upon the EPS of SBI. From Table 4, it

may also be concluded that EPS has increased significantly from 19.614 to 57.482, respectively between pre-bancassurance and post-bancassurance periods.

Summary, Conclusion and Policy Implications

In the present analysis, the CAMEL model has been used to identify the possible gains in profitability of SBI. Simple averages and *t-test* have been used to evaluate the impact of bancassurance on indicators of bank's profitability. The analysis reveals that the bancassurance has improved almost all components of CAMEL model except four indicators namely, Capital Adequacy Ratio (CRAR), Non-interest income (NII), Return-on-Assets (ROA) and Return-on-Equity (ROE). The insignificant improvement in these ratios is the matter of concern and must be taken care of by the policy planners. Though, some of the indicators have witnessed an improvement during the post-bancassurance era, an improvement in the aforementioned variables are required for long-run viability of the bancassurance.

In sum, in case of SBI, bancassurance has done a great job because each and every indicator (taken for this study) has shown positive results. Thus, it is worth to be optimistic about the role of Bancassurance to be played in India. While the benefits of bancassurance appear somewhat clear, prima facie to all participants, the potential areas of conflict should not be glossed over. The success of the partnership depends on the selection of 'right model'. It is vital for this model to ensure that banks remain fully committed to promoting and distributing insurance products. This commitment has to come from both senior management in terms of strategic inputs and the operational staff who would provide the front end for these products. Moreover, regulatory issues need to be addressed comprehensively and sorted out particularly with respect to competition and market structure problems.

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