Examining the Effect of Bancassurance on Capital Adequacy of Public Sector and Private Sector Banks in India

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Abstract

Due to globalization and liberalization, the business environment for banking sector has become very dynamic. The commercial banks are in constant look out for increased financial innovation to gain advantage in the prevailing stiff competition. In this regard, bancassurance is an innovative concept through which the commercial banks intend to generate more revenues with minimal additional investment. The aim of this study is to find out whether bancassurance contributes positively to the Capital Adequacy of commercial banks in India or not. In this regard, primary data were collected from 427 employees of India’s top ten public and private sector banks through a well-framed questionnaire using Likert’s five-point scale, shared through google form, containing appropriate questions on capital adequacy. Authenticated annual reports of the concerned banks were followed for reference with respect to secondary data. The result showed that bancassurance has a significant impact on capital adequacy of commercial banks in India, considered for the study.

Keywords: Indian Banking Sector, Bancassurance, Financial Performance, Capital Adequacy

1. Introduction

Economic development of a country vastly owes to the commercial banking system of that nation. The more it becomes public friendly, the more it wins the trust of clients to form the capital base of the country.

Indian banking sector is one of the largest of its kind in the world. The Reserve Bank of India is constantly introducing reformation in the banking sector to stay ahead of the globalized standard. In this context a series of reformation like demonetization, deregulation of interest rate and dilution of govt. share in public sector banks have taken place in the recent past. Now different public sector banks have been merged to be 12 in total. 21 prominent private sector banks are also operating in the system and this number has been increasing every year. Due to liberalization policy, 45 foreign banks have already entered India of course with the permission of the RBI. Apart from these, 56 regional rural banks sponsored by public sector banks, 1,539 urban cooperative banks and approximately 96,000 rural cooperative banks are operating in India.

So it is obvious that there is stiff competition among the banks to procure business from a fixed base of customers. In such a competitive environment, banks are under pressure to find out something that can secure their survival. In order to stay ahead in the competition, every commercial bank is thinking of adding a new channel of revenue generation beyond the traditional banking activities. Keeping in view the dynamism of the global business environment, banks are going for innovative products or processes which can give them an edge over their competitors. So as a natural corollary, the banks have stepped into new areas and started offering innovative products, like Bancassurance.

The same story continues with the insurance sector in India. 24 life insurance companies and 33 non-life insurance companies are competing in Indian market for their successful existence. They are also in search of a strong distribution channel partner which can substantially contribute to their revenue generation. In this regard, bancassurance appears to be highly beneficial for insurance companies as the customer base of the banks can be convincingly utilized to generate more business for the insurance companies in terms of premium and number of policies. From an overall perspective bancassurance helps in increasing insurance penetration in the country thus ensuring financial protection of the society.

Bancassurance is a combination of two words : bank and insurance. In the prevailing business environment of banking sector and insurance sector, bancassurance proves to be such an innovative product which puts both the sectors in a win-win situation. Bancassurance can be defined as “the ownership and channel integration between an insurer and bank, with the aim to cross sell insurance products through the bank distribution network”. Bancassurance is the concept in which banks and insurance companies have come together to utilize their expertise in the respective fields to give need-based products to customers for financial protection as well as generating more revenue for the organizations. In bancassurance insurance products are sold through the bank branches spread all over India. With addition of bancassurance in the armory, a commercial bank can offer its customers a complete range of financial solutions under one roof.

Financial performance shows the financial health of an institution or organization. Basically it indicates how effectively the organization has utilized its resources or assets to get maximum income. For a commercial bank in India, financial performance is determined by the parameters that constitute the CAMEL model prescribed by the Reserve Bank of India since 1996. The Parameters are Capital adequacy (C), Asset Quality (A), Management Efficiency (M), Earnings (E) and Liquidity (L).

Capital adequa is one of the important constituents of CAMEL model. It indicates the capability of a financial institution to absorb unanticipated financial adversity. It shows the strength of the organisation to meet its obligations. Capital adequacy of a commercial bank is indicated by several ratios such as : Capital Risk Adequacy Ratio (CRAR), Debt-Equity Ratio, Total Advance to Total Asset Ratio and Govt. Securities to Total Investment. Specifically a higher value of CRAR boosts the confidence of depositors and attracts new investors for the bank. CRAR can be determined by dividing total capital of the bank with total risk weighed credit exposure of the bank. Total capital includes Tier-1 and Tier-2 capitals. Equity, intangible assets and reserves come under tier-1. Long-term unsecured loans and debt come under tier-2 capital. As per the Basel Committee recommendation CRAR for banks should be higher than 8%. Proactively, the Reserve Bank of India has made the CRAR mandatory to be 9% for all commercial banks in India.

Waweru (2014) in his study on bancassurance revealed that bancassurance opens up plenty of opportunities to commercial banks to generate more income in way of commission at a comparatively less additional cost. With the addition of bancassurance in the product line, the banks get into a position of optimal utilization of fixed resources as well as providing all verities of financial instruments to customers at a single place.

Banks have a long standing relationship with the customers who have great trust on bank than on insurance companies. It is easier for banks to convince their clients to take insurance products for financial protection of their family thus adding caringness to the relationship. It enables the bank to act as a one-stop solution for its customers with a full range of financial instruments for investments, savings and protection. Bancassurance is convenient to be adopted by the banks as it doesn’t require huge additional investment. It helps the banks to earn non-interest income not just once, but for the entire duration of the policy premium paying term, which plays an important role to maximize the utilization of existing resources and Return on Investment (ROI). Bancassurance helps in generating more business and profit per employee enhancing the Management Efficiency. Through bancassurance, most of the unsecured lending can be covered for any adversity, rescuing the bank from direct loss in case of death of borrowers. Thus, it can contribute in decreasing Non-Performing Assets (NPA). Thus commercial banks can better their financial performance by utilizing bancassurance effectively.

2. Literature Review

Yahaya and Lamidi (2015) in their study opined that financial performance indicates how effectively the organization has utilized its resources or assets to get maximum income. It denotes how far the organization's desired financial objectives are achieved or not. Angima and Mwangi (2016) told in their study that solvency and profitability are key parameters of financial performance of an organization. Indicators like Return on Equity, Return on Asset and Gross Profit in the financial statement speak volume of financial performance of the concerned organization. Generally, people trust banks more than the insurance companies. So banks have better probability of convincing its customers to buy an insurance product. Bancassurance enables the bank to sell a complete range of financial products to its customers under one roof.

In 2004, Aggrawal undertook a study in which he described the practices of bancassurance around the world. For India, he suggested different modes of entry to bancassurance and the subsequent benefits from it. A two-staged process was suggested by him for finding an appropriate bancassurance partner. The first stage would comprise of assessing the financial strength of banks through CAMEL parameters and in the second stage compatibility index would be taken into consideration for shortlisting of banks. In his opinion bancassurance positively contributes to Capital Adequacy Ratio, Return on Assets and Earning per Share which are considered significant in the financial performance of banks. A study was done by Sreesha and Joseph (2011) on contribution of bancassurance to financial performance of State Bank of India. They found that the income generated from selling of life insurance products under bancassurance, contributed positively to financial performance of the SBI.

Another study titled "Profitability Gains from Bancassurance – A Case Study of State Bank of India" was carried out by Grover and Bhalla (2013). They also observed the same positive impact of bancassurance on profitability of the bank. In addition to that they were highly optimistic about the future of bacassurance in India. Another study titled "Growing Role of Bancassurance in Banking Sector" was carried out by Alavudeen and Rosa in 2015. They observed that private sector banks are focusing more on bancassurance and subsequently they are generating more income from bancassurance every year in comparison to the public sector banks in India. Brar and Singh (2016) in their study "Bancassurance: A Study in Relation to Total Income & Branch Network of Pvt. Sector Banks in India" was presented by Brar and Singh in 2016. They found that though bancassurance is profitable to the banks, it hasn't been fully capitalized yet. So banks have substantial opportunities to raise their revenues from bancassurance in the coming days. A paper titled "An Empirical Study on Impact of Bancassurance on Efficiency of Banking Sector in India" was presented by Ranganath and Rao in 2016. They summed up that majority of the commercial banks are increasing their revenues and enhancing their productivity after adopting bancassurance in their product-line.

3. Objective of the Study

- To study the impact of bancassurance on Capital Adequacy of different public sector and private sector banks

4. Research Methodology

The study has taken both primary & secondary data into account for analysis. Primary data are collected from 427 bank employees through a well framed questionnaire, done through both physical mode & Google Form. Secondary data are collected from the bulletins & websites of the concerned banks.

Various statistical tools like descriptive and inferential statistics were applied to achieve the objectives of the study. In descriptive statistics, frequency, percent, means and standard deviation were applied. For inferential statistics, regression analysis, factor analysis, structural equation modelling (SEM) etc. was applied to draw meaningful conclusion. Further, Cronbach's Alpha was applied on each developed scale to test the reliability of data.

5. Analysis of Data

Effect of Bancassurance on Capital Adequacy

The table of impact on Capital Adequacy describes the descriptive and reliability of each of the variables. The variable (CA4) has the highest mean score of 3.939. This means positive contribution to capital levels by bancassurance has helped the banks to tackle any unanticipated risk.

TABLE 1

Descriptive Statistics (Mean & SD) & Reliability test (Cronbach's Alpha) of Capital Adequacy (CA)

Sl.	Statements	Mean	Std. Deviation	Cronbach's Alpha	Cronbach's Alpha	N of Items
CA1	Our bank ventured into bancassurance because it wasn't	3.770	1.4628	0.869	0.855	5

	adequately capitalised					
CA2	Our bank took up Bancassurance which helps in raising levels of capital for the bank to stay ahead of competitors	3.909	1.2309	0.807		
CA3	Bancassurance contributes to form a substantial capital base to protect the bank from insolvency	3.916	1.3135	0.794		
CA4	Higher capital levels arising from bancassurance has enhanced our risk mitigation process	3.939	1.0795	0.837		
CA5	Banc assurance has contributed to enhance the capital adequacy ratio of the bank	3.867	1.1500	0.817		

Source: developed from the survey data

Result shows, the Cronbach's Alpha value for each item and the combined Cronbach's Alpha value is above 0.8 in all the cases. According to Nunnally (1978) and Kline (1994) (Nunnally, 1978; Kline, 1994) value of alpha of a large data size should be higher than 0.70 to be considered as an instrument. Since the value of Cronbach's Alpha is greater than 0.8 in our test, the items in the questionnaire are internally homogeneous and consistent. Therefore, the variables are significantly contributing to the study.

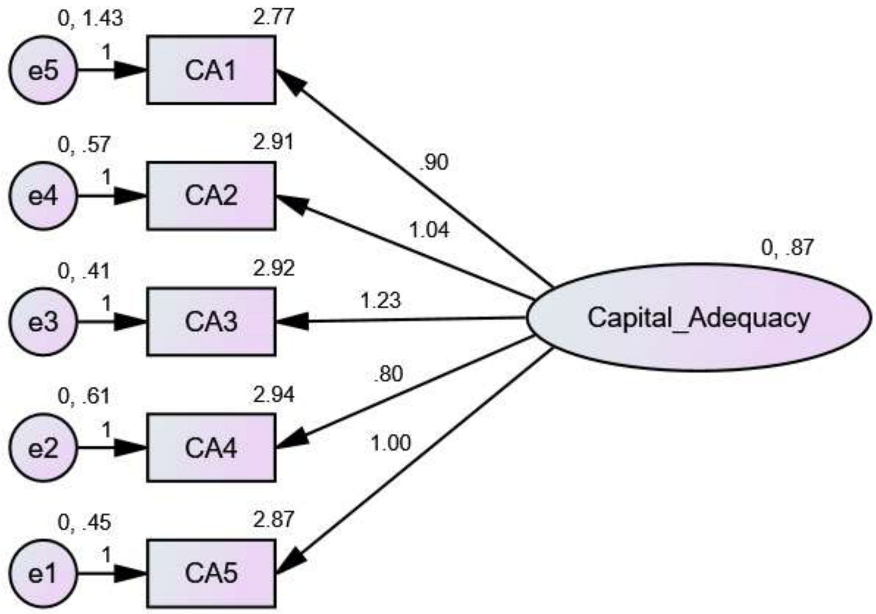

Fig 1: SEM of Impact of Bancassurance on Capital Adequacy (CA)

TABLE 2
SEM of Impact of Bancassurance on Capital Adequacy (CA)

Particulars	CFI	RMSEA	GFI	NFI	RFI
Chi-square = 13.095	0.974	0.101	0.951	0.969	0.938
Degree of freedom = 5 Probability Level = 0.000					

Source: developed from the survey data
CFI: Comparative fit index, RMSEA: Root Mean Square Error of Approximation, NFI: Normed fit index, GFI: Goodness – of-fit, RFI: Relative fit index

Structural Equation Modelling (SEM) was used to determine whether the observed measures are relevant with their corresponding constructs of Capital Adequacy (CA) or not. The model-fit assessment is usually determined by the Goodness fit index (GFI), Comparative fit index (CFI), Normed fit index (NFI), Relative fit index (RFI) and Root mean square Error of Approximation (RMSEA). Any value close to or higher than 0.90 for CFI, GFI, NFI and RFI is considered as a good fit model. In our test all the above said values are higher than 0.9. Moreover, RMSEA shows a very negligible value which confirms the fit of the model.

The fit of the model reveals that each indicator is significantly associated with its intended construct. Significant value of p is less than 0.01 (0.000) confirms the same,

TABLE 3
SEM Path coefficients of Capital Adequacy (CA)

	Particulars		Estimate	S.E.	C.R.	P Label
CA5	<---	Capital Adequacy	1.000			
CA4	<---	Capital Adequacy	0.798	0.054	14.893	***
CA3	<---	Capital Adequacy	1.228	0.063	19.613	***
CA2	<---	Capital Adequacy	1.040	0.059	17.582	***
CA1	<---	Capital Adequacy	0.899	0.075	11.977	***

Source: developed from the survey data

All the p value / label of the variables through path analysis is coming significant at 1 per cent level. In the above table of regression coefficient (estimate) is derived by SEM through maximum likelihood estimates. The path analysis reveals that – regression weights of the above model is structurally fitted well. All the contributing variables of Capital Adequacy are statistically significant and contributing to the SEM. Out of the five different variables, the variable 'Our bank took up bancassurance since adequate capital provides the ultimate protection against insolvency (CA3)' (1.228) and 'Our bank ventured into bancassurance because it wasn't adequately capitalized CA1 (1.040) contribute maximum towards Capital Adequacy.

6. Conclusion

It is evident from the study that bancassurance has a significant impact on Capital Adequacy. It is natural that regular increase in revenue generation from bancassurance will definitely strengthen the banks' financial position. If challenges are properly addressed, bancassurance can play a big role in generating more revenues as well as increasing efficiency of the banks which in turn will definitely better the financial performance of banks. Sincere involvement of bank employees with knowledge and skill and infusing awareness of bancassurance among the bank customers will play a significant role in getting the desired result.

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