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Bancassurance in India: Challenges and opportunities

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Abstract
The banking sector has achieved a deeper penetration especially within the rural areas, where the insurance companies do not have branches. With increased integration of financial services and banks seeking to expand the range of services offered to clients, a perfect opportunity exists for the two sectors to enter into a bancassurance partnership. Bancassurance has been a successful model in the European countries contributing 35 percent of premium income in the European life insurance market. It contributes over 65 percent of the life insurance premium income in Spain, 60 percent in France, 50 percent in Belgium and Italy. In India, the signs of initial success is already there despite the fact that it is completely a new phenomenon. Bancassurance in India has good hope for both sectors-Banking and Insurance, but with lot of challenges.

Keywords: bancassurance, Indian banking sector, insurance industry, insurance penetration, use of technology

Introduction

Traditionally banks transform short-term liabilities into long-term assets. This generates credit risk on asset side and liquidity risk on the liabilities side. The maturity mismatch between assets and liabilities exposes banks to interest rate risk and makes them more vulnerable. The bank can address this specific issue by entering into insurance business. An insurance activity accumulates substantial amount as premium receipt. With the long-term fund, banks can decrease the possibility of liquidity and solvency problems. Even if banking and insurance are carried out as separate entity, through a holding arrangement, the insurance outfit can afford a potential source of liquidity for the parent.

All over the world, governments are known to intervene in the insurance business through regulations to make insurance a catalyst of social development. The Indian government has also issued detailed guidelines regarding this. IRDA has made it mandatory for every insurer who started business after the commencement of IRDA Act, 1999 to ensure the prescribed levels of business from rural and social sectors. The guidelines in this connection indicate that the life insurer must cover a minimum rural business of five per cent in the first financial year; seven per cent in the second financial year, ten per cent in third financial year; twelve per cent in the fourth financial year and fifteen per cent in the fifth year of total policies written during that year. In respect of a general insurer, the prescribed limit is - two per cent in first financial year, three per cent in second financial year and five per cent thereafter of total gross premium income of that year.

In respect of social sector all insurers are supposed to cover five thousand lives in the first financial year, seven thousand five hundred lives in second financial year, ten thousand lives in third financial year; fifteen thousand lives in fourth financial year and twenty thousand lives in the fifth financial year.

These rural and socially disadvantaged sectors are very difficult to service. They are scattered geographically in small indigenous social groups. It is very difficult to identify their need and design products that are viable as well as acceptable to these segments. In fact, the real issue is cost effectiveness. These target clienteles can be addressed by spending substantial amount of money by way of marketing research to identify their needs and promotional measures to reach them. The coming together of banks and insurance can provide substantial synergy here. The banks already have a massive infrastructure spread across the width and breadth of the country. Banks possess a vast array of market intelligence including rural and disadvantaged section of the society. This information can be leveraged to design appropriate products for the specific requirements of target population. The widespread branch network can be used as a marketing channel without incurring significant amount of money. Definitely collaboration between banks and insurance companies can be of great benefit to service this target group in a cost-effective and financially viable manner. In fact, it may be noted in this connection that generally insurance company suffer from substantial amount of losses in the early years of their operation. One of the contributory factors in this regard is social obligations mandated by the government. International experience shows that even in relatively developed countries it takes a long period of time to reach out to less privileged regions and segments of population. Obviously, in India the problem is much larger and more complex. Bancassurance is an appropriate strategy in this connection.

In a service industry such as insurance, which offers promises in return for payment upfront, redemption of commitments has to be perfect. The claims settlement service is mostly affected by problems in decision-making, causing enormous delays. Against this background, joining of hands between banks and insurance offers double-edged solution. The existing track record of banks in providing satisfactory services has been dismal to say the least. In addition, a number of banks had to offer VRS to shed the excess manpower and introduce technology into their service operations. Still, a whisper of next round of VRS can be heard in the banking sector. In such scenario, if banks enter into new and fast-growing sector like insurance the problem of excess staff can be overcome without compromising the morale of the workforce. Of course, banking personnel need rigorous training to adapt to insurance business. In this context, one viewpoint is that the bank employees by their past track record cannot be trusted to become customer-friendly overnight. But if we look at the developments taking place over the last few years, we can say with confidence that bank employees in the public sector have responded in a very encouraging manner to the challenges thrown at them through competition by private sector banks. It implies that given the chance and requisite training, they can also become successful in insurance sector.

In fact, customer expectations are also a function of the level of services made available to them. And the bank employees in the public sector understand them quite well. That is why as and when customers demand better services, banks have provided the same.

Review of Literature

Boyed *et al* (1994) examined customer behavior in relation to the selection of a financial service provider. They examined customer's scores on selection criteria, such as reputation and friendliness by taking into account customer's demographic characteristics, e.g. size of household, household income, age and gender of household head. The results revealed that factors such as reputation, interest charged on loans and interest paid for saving accounts were critical, while less important were friendliness of employees and the modern facilities.

Wever (2000) found that Banks need expertise in product design, underwriting, administration and claims, Banks should use customer's data bases that could use demographic and financial information to generate warn leads for insurance sales, resulting in significant distribution efficiency.

Black et al (2002) examined Customer's choice of financial distribution channels. They showed that consumer confidence, lifestyle factors, motivation and emotional responses influence the customer's choice, while product, channel and organizational factors such as image and reputations are also significant.

Lee and Marlowe (2003) investigated how consumers choose their financial institution. Although consumers' decision-making criteria may vary, dependent on their experiences, socio-economic and demographic characteristics', they found that the most important criterion that consumers use in selecting a financial institution is convenience in terms of location of office and/or other convenience features. Retail fees are the second most frequent reported decision-making criterion followed by the range of services offered and the existing personal relationships.

Hwang and Gao (2005) analyzed life insurance companies operating in the Irish market, measuring cost efficiency with a stochastic frontier approach. The efficiency scores obtained are then regressed on a set of covariates in order to detect the main drivers of performance. The authors concluded that size, market share and dummy indicating bancassurance companies are all positively related to cost efficiency in a statistically significant way. The distribution of insurance products by banks is the adopted operational definition of bancassurance. Consequently, bancassurance firms are those centered on selling insurance through the established distribution channels of their associated banks. The criterion used appears to be related only to the distribution system, while banks presence in the ownership structure of insurance companies is not explicitly considered.

Karunagaran (2006) found that the model is best suited for majority of banks including some major urban cooperative banks because neither there is sharing of risk nor does it require huge investment in the form of infrastructure and yet could be a good source of income. There are some model for bancassurance that belong to situation to apply successfully as Referral model; corporate agency; Insurance as fully integrated financial services/joint ventures. Each model will be relationship level different. The banks knew potential bancassurance in India. Bancassurance strategy was being "win-win situation" for all the parties involved there are banks, insurance companies and customers.

Chen et al (2008) in their empirical study based on panel analysis of a sample 28 firms from developed and developing countries found that size of the national banking industry, the level of financial deregulation within a country, and the national inflation rate play significant role as determinants of Bancassurance.

Artikis et al (2008) had identified profit potential, product expansion, wider customer base, lower distribution costs, stronger brand names, improved products and services, automated and simplified financial transactions affect the bank-insurance interface. In order to leverage the retail network, banks should focus on products that fit the bank's distribution strategy. Bancassurers also distribute their insurance policies for a lower cost than traditional insurers, since they pay lower premium-based commissions than the premiums that insurers pay to their agents or salespeople. While traditional insurers sell policies with high premium-based commissions, banks developed products where commissions on reserves represent the major remuneration to the banks.

Popli and Roa (2009) found that opportunities exists for banks to cross-sell insurance. These opportunities are based on customer's high usage rate of insurance, the low penetration of banks to insurance programs and customer's willingness to buy insurance from bank. The identification of specific insurance products and certain customer segments enhance the bank's efforts to cross-sell insurance product.

Kumaraswamy (2012) focused on the phenomenon of "Universal Banking", which is built on the principle of leveraging existing networks to broaden its portfolio offerings. A bank or a branch becomes a one stop financial provider or a super market of financial services to the customers; when that bank offers vastly expanded and more sophisticated range of products to the customers from the same branch and ultimately this phenomenon is known as "Universal Banking". How insurance is an option for banks? – It fulfills the requirements like asset management, investment skills distribution and capital adequacy, competitive edge over competitors, greater life cycle management, diversification and growth of revenue, diversification of risks by tapping another area of profitability. How bancassurance is beneficial for customers? The ways are – Delivery of all financial services at the doorstep, advisory services under one roof, relief from efforts from search for person or service/products, benefits of choosing multiple products at one place, satisfaction of brand strength of banks, better value and cheaper premiums, reduced premium charges, high quality products and trust on banks.

Present Status: Indian Context

The life insurance industry in India has been progressing at a rapid pace since opening up of the sector in 2000. The size of the country, a diverse set of people combined with problems of connectivity in rural areas, makes insurance selling in India a very difficult proposition. Bancassurance encompasses terms such as 'Allfinanz' (in German), 'Integrated Financial Services' and 'Assurebanking'. The ubiquitous agent is no more the only distribution channel today for insurance products. The motives behind bancassurance also vary. For banks, it is a means of product diversification and a source of additional fee income. Insurance companies see bancassurance as a tool for increasing market penetration and premium turnover.

The customer sees bancassurance as a bonanza in terms of reduced price, high quality product and delivery at doorsteps. Actually, everybody can be a winner here. Will it work in India? That can only be answered in the future; the initial action does show that many banks seem to believe that bacassurance will be a big success here. Some foreign and Indian bans – Stanchart-Grindlays, ABN-Amro, Citibank, HSBC, Bank of Baroda (BoB) and State Bank of India (SBI) – are hoping to replicate the French success of this Insurance-cum-banking model, in India, as elsewhere, banks are seeing margins decline sharply in their core lending business. Consequently, banks are loking at other avenues, including the sale of insurance products, to augment their income. The sale of insurance products can earn banks very significant commissions (particularly for regular premium products). In addition, one of the major strategic gains for implementing bacassurance successfully is the development of a sales culture within the bank. This can be used by the bank to promote traditional banking products and other financial services as well.

Bancassurance is not simply out selling insurance but about changing the mindset of a bank. In addition to acting as distributors, several banks have recognized the potential of insurance in India and have taken equity stakes in insurance companies. However, the evolution of bancassurance as a concept and its practical implementation in various parts of the world, has thrown up a number of opportunities and challenges.

By now, it has become clear that as the economy grows, in not only demands stronger and vibrant financial sector but also necessities to provide with more sophisticated and variety of financial and banking products and services. As India is being considered as one of the fast developing economies among the emerging market economics, the financial sector has also grown much vibrant with the financial reforms. In fact, in recent years, it is surmised that even the 'global economic growth' hinges on growth prospects of the emerging economies like China and India to a greater extent. Experience also showed that economic growth has strongly supported the expansion of the middle income class in most of the Asian countries, and now it is India's turn. Experience reveals that at the initial growing stage of the economy, the primary financial needs are met by the banking system and the thereafter, as the economy moves on to a higher pedestal, the need for the other non-banking financial products including insurance, derivatives, etc. was strongly felt. Moreover, as India has already more than 200 million middle class population coupled with vast banking network with largest depositor's base, there is greater scope for use of bancassurance.

By now, it has become clear that as economy grows, it not only demands stronger and vibrant financial sector but also necessitates providing with more sophisticated and variety of financial and banking products and services. Krueger (2004) pointed out that the history of the North America is a case in reference of one of financial strengthening and deepening in tandem with economic growth. As India is being considered one of the fast developing economy among the emerging market economies, financial sector has also grown much vibrant with the financial reforms. In fact, in recent years, it is summarized that even the 'global economic growth' hinges on growth prospects of the emerging economies like China and India to a greater extent.

Significantly, Indian economy has recorded an average growth of over 7.5 per cent for the last years, with macroeconomic and financial stability (RBI, 2011) and indications are that it may grow at even better rate in the near future provided there is good monsoon. Experience also showed the economic growth had strongly supported the expansion of middle income class in most of the Asian countries, and now in the turn of India. Experience reveals that at the initial stage of economy the primary financial needs are met by the banking system and thereafter as the economy moves on to higher pedestal, the need for the other non-banking financial products including insurance, derivatives, etc. were strongly felt. Moreover, as India has already more than 200 million middle class populations coupled with vast banking network with largest depositors' base, there is greater scope for use of bancassurance. It is worth being noted that, Swiss Re (2002) in its study on Asia pointed out that bancassurance penetration is expected to tangibly increase in Asia over next 5 years and this has been greatly proved by 2010. In simple words, it is aptly put that bancassurance has promised to combine insurance companies' competitive edge in the production of insurance products with banks' edge in their distribution, through their vast retail networks (Knight, 2006).

In the post reforms, the financial sector has more number of players of both domestic and foreign 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 which in turn had a strong bearing on the banks' net interest margin (Spread). In fact the emerging scenario is likely to bring down the bank's spread ever thinner 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.

Banks' response to these developments has been to migrate towards newer and non-traditional areas of operation especially relating to fee based activities/non-fund based activities. This is reflected in the sharp increase of proportion of non-interest income to total income in recent years. Further, banking system in India was prone to very high NPAs; the net NPA ratio of banking sector was as high as 15.7 per cent at end-March 1997, which, with concerted efforts has declined sharply. Although this was an unprecedented achievement in the Indian banking industry, diversification towards new areas such as bancassurance, promises greater scope for further enhancement in earnings with no menace of increase in NPAs.

In the ensuing paradigm, the banking sector irrespective of public or private sector and foreign or domestic banks', their increased reliance on the non-fund-based business activities would become inevitable. Persistent endeavour in scouting for new technology, new products/services/ne avenues, has become necessary for the growth as well as sustainability of banking system. It is in this context possibly, bancassurance could well be an appropriate choice for banks to increase their stable source of income with relatively less investments in the form of new infrastructure.

Untapped Opportunities

- The first and foremost objective indicators of insurance potential in a country are insurance penetration, i.e., premium as percentage of GDP and insurance density, i.e., premium per capita. India, with an insurance penetration of 2.3 percent and insurance density of $ 8 belongs to one of the lower rungs. These indicate that a lot of potential does exist in both life and non-life areas for the insurance industry as a whole and bancassurance too.
- Today, life in general, has become more uncertain and risky. Not only are man-made dangers (burglary, accidents, terrorist activities, hijacking, etc.) on the rise but natural catastrophes (earthquake, flood, cyclone, etc.) are also becoming more frequent. One certainly does not welcome such uncertain times, but these uncertain times create opportunities for insurance business.
- The financial environment has become equally uncertain due to liberalization measures and financial scams. Interest rate deregulation, combined with pursuance of bringing in a soft interest rate regime, has resulted in rates of interest on all financial instruments coming down substantially. In India, where no good old age pension scheme, public healthcare system or unemployment welfare scheme exists, where will the public, particularly the middle class, which no doubt wants return but safety and liquidity first and foremost, save money? The stock markets have become highly unreliable and are tainted with scams, and mutual funds have moved in tandem with stock markets. Money market instruments are still undeveloped. Many urban banks in various parts of the country have failed or become fragile. Against this backdrop, life products, at least, give tax benefits and future security. In fact, taking tax benefits into account, the return on certain life products are more than on bank savings products, as interest earned on the latter, beyond a certain stipulated sum, is taxed at source, like dividends earned on shares. Thus, the moral of the story is that life products still have a bright future even though there are several competing products from banks and other financial intermediaries. Further, the gap between bank savings products and certain life products is fast narrowing.
- The joint family system, which functioned like an insurance system, is gradually collapsing due to several reasons. More and more nuclear families are coming up, and with this, the demand for life-cover for the family and family members is also rising.
- An outcome of the above-mentioned phenomenon is that the elderly members in families are being gradually required to manage themselves either out of their own volition of not becoming dependent on their children or being compelled in one way or the other by their children. Thus, the future older generation has to plan for their financial safety and security in their old age, and the awareness is also increasing in this regard. This speaks well for life insurance products.
- With economic growth, per capita disposable income is also rising. The biggest force to reckon with here is the middle class population, which, according has been catalysed by higher awareness about savings culture being spread through various media by financial institutions.
- Today, as bank branches are the origins for financial needs of any productive venture, these branches can simultaneously sell insurance products to borrowers, particularly non-life products, instead of obtaining the same non-life cover from other insurers. Such a one-stop mechanism may also save the borrower many headaches.
- Bancassurance provides a good opportunity for Indian bank to increase their fee-based income. The Indian bank net interest margin or spread has come down substantially, whereas their operating cost has been increasing. The trend is expected to continue in the near future. Increased fee based income through distribution of insurance products will compensate for the loss in spread. Moreover, in cases where insurance business is carried out as a subsidiary, the dividend income from the subsidiary will also add to the parent bank's profitability and return on assets.
- Recently, the Central Government has approved a voluntary retirement scheme for the insurance sector. This would provide an opportunity to bancassurers to hire such retired insurance, i.e., readymade talent, into their business.
- During the last couple of years, banks have been flush with deposits, whereas credit deployment has been slow- both due to several socio-economic reasons. Bank are investing in government and approved securities, overshooting the SLR ceiling. Therefore, banks now get an opportunity to focus on selling insurance products instead.
- Some areas with good potential for bancassurance are health insurance, credit insurance, travel insurance, capital market-related insurance and pension.
- It is one of the basic ways to increase return on assets because they can increase their fee income through sale of insurance products. Banks that effectively cross-sell financial products can leverage their distribution and processing capabilities for profitable operating expense ratio.
- Banks with their wide branch network spread all over the country (66, 700 branches) can have a very good opportunity to enter the insurance business. India's 27 public sector banks account for close to 92 percent of total network has among other things 33,000 rural branches and 14,000 semi-urban branches, where insurance penetration remains largely untapped. Huge manpower (8, 74, 170 staff) of all public sector banks will help in effective distribution of Insurance products.
- In today's competitive environment offering more and more services under one roof would also help banks to improve their market share.
- Huge customer database containing the names, profiles and contact numbers of banks can be of great use to insurance companies, since minimum average conversion from the bank database into sales will mean a higher productivity than their agencies. They also have access to multiple

communication channels such as direct mail, ATMs, telemarketing, Internet banking etc.

- This new venture would also help banks in better Asset Liability Management. Banks convert liquid short-term liabilities into long-term assets. It exposes them to default rate risk, liquidity risk and interest rate risk.

Challenges in the Way

- Bancassurance products being “push” products, require a totally different mindset and work culture. Whether the existing staff of banks can achieve this is a big question. Have the Indian banks, which have Mutual Fund subsidiaries, succeeded in selling mutual fund products through their bank branches? Certainly not. The issue of cultural incompatibility can impede bancassurance business to a great extent. Alternatively, if the insurance subsidiary of the bank has to maintain the entire paraphernalia, comprising research, administrative, distribution and other staff, it would be too costly, and in some cases, the cost restrictions would not permit it to indulge in this.
- Further, since life products and banking products are similar, efforts to market the former will be less cumbersome for the bancassurance company. However, non-life products are entirely different from life or banking products and are far too complex, with high counter-party and reinsurance risks, and hence, it would be difficult for bancassurance companies to enter into insurance business immediately, until and unless they develop and certain the required skill.
- The manner in which insurance profits develop poses a threat to successful operation of bancassurance. An analysis of profit signature, i.e., the time pattern over which profits of the insurance sector develop, shows that worldwide, the breakeven period of time before ranges between 6 and 8 year (unless the company is captive). For life insurance business, this works out to 8-10 years. This is because initial procurement costs are high. In some countries, commissions and expenses required to earn first year’s premium are much higher than 100 percent. In India, these stand at 90 percent for the first year’s premium. On the other hand, distribution of profits is tightly regulated. In India, only 5 percent of the actuarial surpluses can be distributed as dividend. Does this bode well for bancassurance?
- LIC and the four subsidiaries of GIC are well established in their respective lines of businesses. Opening up the insurance sector has also awakened them, and being old players, they would like to take their competitors who are new, by the horns. Thus, they will strive to become more competitive, and will be buttressed by their financial and non-financial strength, including the lobbying power. This would pose a threat to the new bancassurers. Too much of competition may lead to accentuation of the adverse selection and moral problems, which may ultimately prove detrimental to the insurance industry as a whole.
- Success of bancassurance would also depend on the extent to which and how fast the technology being used for banking operations can be used for meeting the technology requirements for insurance business. Otherwise, banks will have to incur large investments for putting in place the technological infrastructure for bancassurance operations.
- In case of failure of the bancassurance operation, the bank runs the threat of image risk and cannibalizing deposits (i.e. there may be a fear among the staff that investment-oriented life insurance products may eat into the deposit base of the branches).
- Insurance sales being commission/incentive driven, banks selling insurance products may be required to provide incentive packages in addition to the regular remuneration to drive the sales.
- Maintaining the same service levels for insurance business as that for the banking services may be one of the biggest challenge.
- Private players in the insurance industry being new entrants are technology-savvy. Banks, especially PSBs, have to rise up to the challenge and be willing to invest in technology.

Conclusion

Due to merging of global financial markets, development of new technologies, universalization of banking industries and with expansion of non-banking activities, the insurance industry has globally brought in new channels of distribution into existence. Various insurance companies are proposing to bring insurance products into the lives of the common person by making them available at the most basic financial point, the local bank branch through bancassurance. Bancassurance concept originated in France and soon became success story even in other countries. Bancassurance is the simplest way of distribution of insurance products through the bank distribution channel. It is process of selling insurance products and services by leveraging vast customer base of a bank and fulfills the banking and insurance needs of the customers at the same time.

It is not just about selling insurance products to banks customers rather it also exploits the true synergies between, and respective strengths of the banks and insurers. Benefits to insurers, banks and customers while using Bancassurance as insurance distribution channel vary. The bank network is spread across the length and breadth of the country. This enables the insurance companies to reach out to each individual in the country who need insurance. From the bank’s perspective, such a model offers a great opportunity to improve their profitability by enhancing fee-based income. This income is purely risk free for the bank since the bank simply plays the role of an intermediary for sourcing business to the insurance company.

The road to Bancassurance has been laid. A few Bancassurance vehicles have started their journey on the road; but they have miles to go. Bancassurance ventures should primarily strive to remain safe and sound through proper corporate governance, risk management and operational practices. Good customer service should remain another important goal of bancassurers. In a competitive market, where products are cloned in no time, customer service provides one with the necessary cutting edge to remain ahead of others. In this, technology will have a dominant role to play. Product research through market surveys is also essential. Nevertheless, bancassurers, at least for some time to come, will concentrate on urban and life areas of business.

The convergence of banking and insurance in India happens due to market pressure. The contribution of Bancassurance will be substantial. The ability to tap into bank’s huge customer base is an irresistible opportunity for insurance companies. The scope to benefits from the generous commission pay-out by insurance companies is a great attraction for banks.

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