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Bancassurance and Profitability of Selected Commercial Banks in Kenya

Joseph Kamunya

MBA (Finance) Student, Kenyatta University, Kenya

Dr. Job Omagwa

Lecturer, School of Business, Department of Accounting & Finance, Kenyatta University, Kenya

Abstract:

The banking sector in Kenya plays an important role in the growth of the economy, and thus this sector needs to be stable, over the years this sector has faced challenges which have impacted on profitability of most institutions. Hence, the sector adopted the concept of Bancassurance as a form of diversification to improve its fortunes. However, despite the introduction of this sophisticated concept, there is very little empirical evidence on whether the concept has a significant effect on Profitability of the banks which have largely adopted the concept. And this was the thrust of this empirical investigation. The objective of the study was to determine the effect of bancassurance on profitability of selected commercial banks in Kenya, between the years 2012 to 2016. Profitability was operationalized into Net income, Return on Asset and Return on Equity. The study adopted descriptive survey method. Purposive sampling was used to pick respondents for the study; the target population of six best commercial banks in Kenya was adopted. These were banks offering bancassurance services. Data was analysed by descriptive statistics and multiple regression analysis. Data presentation was in the form of tables and graphs. The study found a positive and statistically significant effect of interest income from banc assurance, customer retention and acquisition and the risk diversification on financial performance of selected commercial banks in Kenya. The number of insurance products on offer did not have a statistically significant effect on profitability of the banks under study. Hence, the study concludes that Bancassurance is a significant component of the banks revenue stream which should be given more prominence as the banks strive to remain profitable.

Keywords: Bancassurance, Profitability, Return on Asset and Return on Equity

1. Introduction and Background

Profitability of commercial banks have of late being a concern in the financial sector, the dwindling income from traditional Banking, due to changes in the saving nature of banks customers has forced banks to assess new opportunities to maintain profitability. According to Locatelli *et al* (2003) In Kenya banking sector is expected to contribute greatly to the realization of Kenya Vision 2030 (Republic of Kenya, 2007). An efficient banking sector contributes positively to economic development by promoting capital accumulation through supply of credit.

The concept of Bancassurance originally meant simple distribution of insurance products by Banks branches, today it is used to describe all kind of relationships between the Banking and Insurance industries (Quagliarello, 2004). According to (Insurance Regulatory Authority report, 2012) Bancassurance has helped commercial banks expand their product and services, offered to their customers, improve on their satisfaction as well as retain most of the clients. (Elpash 2012) Banks are now investing in financial innovations and venturing into new areas such as internet, mobile, commodity banking, and Bancassurance. Bancassurance as bank strategy to venturing into other areas of business and diversification has positive impact to its profitability. Providing a variety of financial services to the same customer base enhances customer loyalty. This could have positive impact on the long-term earning of the bank. (Jongenee, 2011) stated that by being a one stop-shop financial solution, a commercial bank seizes the opportunity to grow in importance, also bancassurance provides additional income to the bank known as fee income. Brealey and Meyer (2013) further noted that diversification bring scale which may make it easier to attract professional management, gain access to international financial markets.

There were four independent variables studied. These include Interest earned income, Number of insurance products, Customer retention and acquisitions and Risk diversifications, Dependent variables were Level of net income, Return on asset and Return on equity. The study sought to find out the significance of the above variables as used in bancassurance to affect profitability of selected commercial banks in Kenya, and how management could give full support to by way of resources and moral to staff to facilitate adoption and implementations of bancassurance.

2. Research Problem

Commercial banks in Kenya have had to come to terms with the ever-reducing interest margins as a result of increasing competitions, change in technology, De-regulations of the financial sector as well as globalization. Interest being the banks major source of income is the difference between the lending rate and the borrowing rate charged to customer, but because cost of borrowing is rising, many would be customers are shying away from borrowing, reducing the profitability of banks (Kumar,2006)

Kenyan government have liberalised the banking sector, thereby allowing other players to join the sector making it even more competitive (Kiragu, 2014).Savings and credit societies (S.A.C.C.O) have continued to put more competitions as some have opened front office services and are now able to give loans at a competitive rate, with introduction of Mobile Money transactions by Mobile phone services providers, Safaricom, Airtel and Orange telecom, stiff competition has ensured for the customers, Few studies have been done relating to Bancassurance in its entirety.(Omondi, 2013) did as study on determinant of adoption of banc assurance by commercial banks, The study focussed on influx of new revenues and business diversification as brought about by banc assurance. Kiganda (2014) investigated the effect of macroeconomic factors on commercial banks profitability in Kenya, focusing only on one banks; Equity Bank Limited. The result of the study shows that macroeconomic factors have no significant role in bank profitability. However, he found that board and management decisions determine commercial banks performance in Kenya. Most of the studies undertaken were not conclusive about the effect of the various determinants of banks performance. In view of the above the researcher has sought a specific view by researching on effect of Banc assurance on profitability of top six commercial Banks in Kenya.

3. Objectives of the Study

The study sought to achieve the following objectives:

- (a) To establish the effect of interest income on profitability of commercial banks in Kenya.
- (b) To assess the number of insurance products effect on profitability of commercial banks in Kenya.
- (c) To determine the effect of Customer retention and Acquisition on profitability of commercial banks in Kenya.
- (d) To assess the effect of risk diversification on profitability of commercial banks in Kenya.

* Null hypothesis was tested in view of each respective specific objective at a level of significance of 0.05.

4. Significance of the Study

This study will be valuable in that it will provide further information and knowledge into Banc assurance and can be used as a starting point to acquire further information by academic students and researchers, who can use the information to build more knowledge into the field of Bancassurance, and also get topics for further study where gaps exist. In addition, the study could be used by commercial banks that want to venture into the field of banc assurance and by Government to formulate policies for the growth of Banc assurance in Kenya. The government should provide strategies for growth for Banks as this will have positive impact on the overall growth of the Economy. As results, this study could prove to be useful as its analyses could be used by government to formulate new policies that could reduce the hindrance of growth of this financial innovation.

5. Review of Literature

5.1. Theoretical Review

The study was anchored upon three theories as reviewed here under. Financial Intermediations Theory is the transfer of fund from the agencies that have a surplus to agencies that have a deficit through financial intermediary's alexandru.*et.al* (2009). The theory came about from three different approaches, theory of information symmetry, Transactions cost theory and, and theory of monetary regulations, Bert and Dick (2003). The theory of information symmetry was developed by (Gurley Shaw 1960) which emphasized that intermediaries came about as result of information symmetry leading to high transaction cost. The need to reduce the effect of imperfect market gave rise to financial intermediaries as they were seen to eliminate or reduce transaction costs through pooling of Resources of individual customers leading to scale of economies Alexandru *et.al* (2009). At the level of transactional technologies Alexandru *et.al* (2009) through their functions of processing huge volume of data at high efficiency, clients perceive that they are expert at making the best financial decisions. Bancassurance proves to be worthwhile vehicle for both the banks and insurance companies through the concepts of financial intermediation. This will improve companies' profitability as efficiency, reduced transactions costs help to enhance this.

Theory of Economies of scale refers to cost advantage that an enterprise obtains due to size, output or scale of production. Economies of scale are Internal, External, National, and International, aggregative or dis-aggregative. This theory was laid out by (Marshall, 1890). Marshals assigned the key role to external economies in his attempt to reconcile increasing return and competitive equilibrium. It is argued that Marshall chief purpose in creating the category of external economies was to explain the great historical reduction in production cost associated with increased output Roy and Wilfred (2011) To the extent that Marshall envisaged the advantages available to small firms as arising from the general progress of industries, and although he clearly distinguished between external and internal economies there was clear conclusion that the two sources are seen to co-exist. The availability of external economies to firms seems to increase with the scale of industry output,

a factor which also induces the average size of the firm to increase, and there for the availability of internal economies (Roy and Winfred, 2011). The more insurance product a bank sell, the more experience it will gain along with scale advantage and ultimately, the marginal selling cost can decrease. A reduction in cost by commercial banks is a positive strategy to enhance its profitability.

The modern portfolio theory was developed by (Markowitz, 1952) he drew attention to the common practice of portfolio diversification and showed how an investor can reduce the standard deviation of portfolio return by choosing stock that does not exactly move together. The rule states that an investor should diversify his funds among all the securities which gives maximum expected returns, Markowitz went on to work on the basic principles of portfolio constructions that eventually lead to the concept of efficient portfolios. According to (Markowitz, 1952), portfolio that gives both maximum expected returns and minimum variance should be commended to the investor. An efficient portfolio consist of set of assets that gives either high return for a given level of risk or low risk for a given level of return, in essence, a shrewd investor may reduce the risk of a negative return by holding a portfolio of different asset in order to mitigate the risk of loss should one of those asset not produce the expected outcome, that is diversification, which makes portfolio risk to be less than the average risk of the separate stocks Brealey and Myers (2013) Over the years banks have realized that there is need to diversify their portfolio offering to remain relevant, increase their earning and maintain their sustainability in the ever increasing competitive financial environment.

5.2. Empirical Review

Krstic *et al.* (2011) investigated bancassurance as one of the new option for the development of Serbian financial industry, in Eastern Europe. The study found out that banking and insurance are two inextricably related part of the financial sector and the interconnections between them are particularly strong in times of crises, this study on banc assurance on Serbian financial industry also established growing presence of a model of integrated performance of bank and insurance companies in the market exhibited by provisions of banking and insurance services in one place through the form of banc assurance. Banc assurance benefit the banking industry in the time of increasing competition among participant in the financial market including; expanding the base of client, retaining the existing client, increasing profit, as well as improving the supply through a creation of new products according to the structure and needs of clients.

Nyathira (2013) Studied the effect of financial innovations on the financial performance of commercial banks in Kenya, covering a period of four years. A causal research design was used, population of forty-three banks in Kenya as licensed by the central bank as at 30th June 2012. Secondary data from published Central Bank's annual report was used and the population of study the independent variable was financial innovation unique to commercial Banks while the Dependent variable was the financial performance of all Banks. The results shown that financial innovations indeed contributed to and was positively correlated to profitability in the banking sector, particularly that of commercial banks. This was further supported by high uptake of efficient financial systems in substitute of the less efficient traditional systems.

Otieno (2012) Reviewed financial services in Kenya; a case for institutional reforms and partial consolidation of the regulatory framework. This study set out to make a case for institutional reforms and partial integrations of the financial service sector in Kenya. Sectors identified for reforms and integrations include banks and insurance companies. The case for reforms followed by integrations necessitated by several circumstances. The study established that the financial services in Kenya were highly integrated today The integration included cross-marketing of insurance products by Banks (Banc assurance) thereby posing the challenge of 'circumvention of regulation' for the present regulator of the two sectors and also merging of banks, like CFC-stanbic Bank and establishment of financial services units within certain financial institutions like Cooperative Bank, pose a challenge to regulators and call for a single regulatory authority in the market.

6. Methodology

The study adopted descriptive design. The target population was the big six commercial banks (in Kenya) offering Bancassurance services. These were among forty-three registered banks, covering five years from year 2012 to year 2016. Forty-two respondents were supplied with questionnaires to obtain primary data, while secondary data was obtained from published accounts, central bank of Kenya annual report and insurance regulatory authority reports. The study adopted purposeful sampling from the target population; Data collected was analysed using descriptive statistics that yielded tables, charts, mean and standard deviation that was used to give meaning to the data collected. In addition, multiple linear regression analysis was used to test the relationship between bancassurance and profitability of commercial banks in Kenya.

7. Results and Findings

The output of the research effort is summarised and presented in the tables below. The study used means and standard deviations for purposes of descriptive analyses.

7.1. Descriptive Analysis

	Mean	Std. Deviation
Bank commission has increased due to introduced Motor vehicle insurance	4.1000	1.47679
Bank commission income has increased due to introduced asset insurance product	3.8778	1.39685
Bank commission has increased due to life insurance product, introduction	3.6778	1.28804
Bank commission has increased due to introduction of cash on transit insurance product	3.4556	1.11336
Bank commission has increased due introduction of loan insurance product	2.9333	1.06844
Means	3.61	

Table 1: Number of insurance products
Source: Survey data, 2017

Refer to the Table 1. Above, where the study investigated several aspects under number of insurance products the commercial banks had. The scores of strongly disagree and disagree have been taken to represent a variable which had mean score of 0 to 2.5 on the continuous likert scale; ($0 \leq L.E < 2.4$). The scores of 'moderate' have been taken to represent a variable with a mean score of 2.5 to 3.4 on the continuous likert scale: ($2.5 \leq M.E < 3.4$) and the score of both agree and strongly agree have been taken to represent a variable which had a mean score of 3.5 to 5.0 on a continuous likert scale; ($3.5 \leq G.E < 5.0$).

From the study, findings showed that majority of the respondents agreed to a great extent that the Bank commission has increased due to introduced Motor vehicle insurance, with mean of 4.1. Bank commission income has increased due to introduced asset insurance product, with a mean 3.8 indicating that they agreed, and Bank commission has increased due to life insurance product, introduction, with a mean of 3.67. Moreover, the respondents agreed to a moderate extent that Bank commission has increased due to introduction of cash in transit insurance product and bank commission has increased due introduction of loan insurance product, with a mean of 2.93. However from table 1. above, the deviation from the mean of the four variables studied were wide spread around the mean, with standard deviation of more than 1, field (2013) indicating that responses were spread from, disagree, moderate, strongly agree and agreeing with aggregate mean of 3.61. The findings imply that the banks offered several numbers of insurance products, which had a significant effect on performance of commercial banks under study.

	Mean	Std. Deviation
Bank assurance has improved ROA of the bank	3.5889	.92280
Bank assurance has improved profit margin	3.3778	1.04481
Bank assurance has improved effective utilization of resources	3.1444	1.11739
Bank assurance has improved Return on equity (ROE)	3.0667	1.28071
Bank assurance has improved the fees based income	2.9847	1.34562
Mean	3.23	

Table 2: Risk Diversifications.
Source: Survey data, 2017

Refer to Table 2. Above, findings from the study show that majority of the respondents agreed to a great extent that bank assurance has improved ROA of the bank, with a mean score of 3.58 indicating that profit margin have improved. ROA also shows how efficiently the resources of the company have been used to generate the income. However, majority of the respondents agreed to a moderate extent that bancassurance has improved profit margin, with mean score of 3.37. Bank assurance has improved effective utilization of resources, with a mean score of 3.14 indicating that profitability was improved. The findings also showed that bancassurance has improved Return on equity (ROE) and bank assurance has improved the fees based income. However, from table 2. the results show that the deviation from the mean for the first one has standard deviation of less than 1, indicating that most responses were answered close to the mean, (strongly agree and agree) but for the rest of the variables examined the responses were varied as the standard deviations were more than 1 showing that responses were spread from moderate, strongly disagree and disagreeing. The findings imply that risk diversifications had a significant effect on profitability of the selected commercial banks.

	Mean	Std. Deviation
Bank customers has increased due to introduction of motor insurance	3.9778	.94783
Bank customers has stabilized due to introduction of Asset assurance	3.6111	.90807
Bank customers has opted to remain due to introduction of Life insurance	3.3222	.55744
Bank customers has increased due to Cash in transit insurance	3.1889	.51700
Mean	3.53	

Table 3: Customer Retentions and Acquisition
Source: Survey data, 2017

Refer to Table 3. above research findings showed that majority of the respondents agreed to a great extent that bank customers has increased due to introduction of motor insurance with a mean score of 3.97 an indication that they agreed. Fiordelisi and Ricci, (2011) cited that one of the advantage of banc assurance is that it ensures that customers are retained and new ones are attracted. And bank customers have stabilized due to introduction of Asset assurance, with a mean score of 3.61. However, respondents agreed to a moderate extent that bank customers have opted to remain due to introduction of Life insurance and bank customers has increased due to Cash in transit insurance. Also result from table 3. above shows that the deviation from the mean was less than one for all the variables under study with standard deviation of 0.94, 0.90, 0.55 and 0.51 respectively showing that respondents answered very close to the mean score, from moderate to strongly agree and agree. The study findings imply that the performance selected commercial banks was influenced by customer retention and acquisition, with an aggregate mean score of 3.53 of those who agreed and strongly agreed.

	Mean	Std. Deviation
The Bank has earned significant commission	4.0556	.85277
The commission earned has improved overall profitability of the bank	3.7667	1.34122
The new commission has necessitated employment of new staff	3.5000	1.08359
The new commission has helped to improve Business volume of the Bank	3.0778	.72248
Mean	3.6	

Table 4: Interest Earned Income.

Source: Survey data, 2017

Refer to Table 4. Above, findings from the study found that all the respondents agreed to a great extent that the bank has earned significant commission; by a score of 4.05 the commission earned has improved overall profitability of the bank and by a score of 3.76 The new commissions has necessitated employment of new staff, by score of 3.5 However the respondents agreed to a moderate extent that the new commission has helped to improve Business volume of the bank, by score of 3.07. However from table 4. above results shows that the deviation from the mean was less than one (1) as standard deviation was 0.85 and 0.72 respectively showing that the respondents answered very close to the mean score, from moderate to strongly agree and agree, while the rest of the variables had standard deviation of more than one (1) showing that the respondents were widespread around the mean, from strongly agree to agreeing. The findings are of the implication that interest earned income has an influence on the profitability of the selected banks. And is in agreement with Nyathira, (2013) who concluded that in deed financial innovations contributed to and was positively correlated to profitability in the financial sector, mostly commercial banks.

7.2. Regression Analyses

The section presents statistical output for multiple regression analysis as well as the interpretation.

Model Summary				
Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.943 ^a	.889	.872	.00350
a. Predictors: (Constant), Risk Diversification, Interest Income, Customer Retention and Acquisition, Number of Insurance Product				

Table 5: Model Summary

Source: Survey data, 2017

From the model summary in Table 5 above, the values of R, R², adjusted R and the standard error are presented. The output of Pearson's simple correlation (0.943) indicates a strong positive correlation between bancassurance and profitability. Similarly, the value of R² (coefficient of determination) is .889 which is an indication that interest income, customer retention and acquisition, number of insurance product and risk diversification collectively explain 88.9% of the variability of banks profitability. The other 11.1% is not explained by the model. The adjusted R squared is the percentage of the variance in the dependent explained uniquely or jointly by the independent variables, From the 87.2% variations in the financial performance can be attributed to the combined effect of the predictor variables, namely, interest income, customer retention and acquisition, number of insurance product, while 12.8% changes in financial performance can be attributed to other factors.

ANOVA ^a						
Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	.002	4	.001	50.193	.000 ^b
	Residual	.000	25	.000		
	Total	.003	29			
A. Dependent Variable: Profitability						
B. Predictors: (Constant), Risk Diversification, Interest Income, Customer Retention and Acquisition, Number of Insurance Product						

Table 6: ANOVA

Source: Survey data, 2017

Table 6 above indicates how the independent variables are collectively statistically significant in predicting the dependent variable. This is in view of the p-value of 0.000 hence, the model overall is a good fit. The F-ratio tests whether the regression model is fit for the data. From the ANOVA table, it can be observed that the F-ratio can be stated as $F(4, 25) = 50.193$, $P < 0.05$ meaning that interest income, customer retention and acquisition, number of insurance product and risk diversification have significant effect to profitability of selected commercial banks in Kenya collectively.

Coefficients							
Model	Unstandardized Coefficients		Standardized Coefficients	T	Sig.	95.0% Confidence Interval for B	
	B	Std. Error	Beta			Lower Bound	Upper Bound
(Constant)	1.044	.005		213.245	.000	1.034	1.055
Interest Income	.020	.008	.256	2.684	.013	.005	.036
Number of Insurance Product	.008	.007	.174	1.230	.230	-.006	.022
Customer Retention and Acquisition	.088	.006	1.267	13.738	.000	.075	.102
Risk Diversification	-.068	.011	-1.030	-8.014	.000	-.111	-.065
a. Dependent Variable: Profitability							

Table 7: Coefficients

Source: Survey data, 2017

*The model below is founded on only the independent variables which were statistically significant. Hence, number of insurance products is omitted.

$$Y = 1.044 + .020X_1 + .088X_3 - .068X_4 + .005$$

Where: Y =Profitability, β_0 = Constant, β_1 - β_4 : Beta coefficients, X_1 = Interest Income, X_3 = Customer retention and acquisition, X_4 = Risk Diversification and ϵ = Error term

According to the regression equation established, taking all factors (interest income, customer retention and acquisition, number of insurance product and risk diversification) constant at zero, the profitability of selected commercial banks will be 1.044. The results further indicate that taking all other independent variables at zero, a unit increase in interest income will lead to a .020 increase in profitability of selected commercial banks. A unit increase in the number of insurance products will lead to a .008 increase in profitability of selected commercial banks all else held constant; a unit increase in customer retention and acquisition will lead to a .088 increase in profitability of selected commercial banks all other factors held constant whereas a unit increase in risk diversification will lead to a -.068 decrease in profitability of selected commercial banks in Kenya all other factors held constant.

The hypotheses were tested using p-value method. A hypothesis was rejected if the p-value was less than the significance level of 0.05. In view of interest income ($p=0.013$), is less than the significance level, indicating that the variable had a significant effect on the profitability of selected commercial banks in Kenya. For customer retention and acquisition the significance level as measured by p-values of .000 (which is less than 0.05) indicating that the variable had a significant effect on the profitability of selected commercial banks in Kenya. With respect to risk diversification, the p-value was similarly 0.000 indicating that the variable had a significant effect on the profitability of selected commercial banks in Kenya. However, number of insurance products with a p-value of 0.230 meant that the variable does not have a significant effect on the profitability of selected commercial banks in Kenya.

The four variables studied, only three had significant effect on profitability of selected commercial banks in Kenya. The finding is in agreement with several writers, who include Krstic *et al* (2011), who noted that banking industry was benefiting from banc assurance from the aspect that client base was being expanded, an indicator that there was customer retention and acquisition. On risk diversification, Nyakundi (2013) found out that bank assurance was one of the risk mitigation strategies used by Equity bank to resolve problems of loan defaulting that led to high credit risk as well as declining profits thus affecting the performance of the banks. It was found that there was a strong correlation between risk diversification as a bank assurance aspect on the profitability of the bank.

Apart from what have been studied, other factors are also known to influence profitability of commercial banks in Kenya, the issue of ownership of the banks selected, it is argued that foreign owned banks perform better than locally owned banks according to (Farazi et al, 2011) this is because foreign owned firms are believed to have tested management expertise in other countries over the years. More over foreign banks often customize and apply their operations systems found effective in their home countries (Ongore, 2011) it is also assumed that banks crossing boundaries are those one which are big and successful ones.

8. Conclusions and Recommendations

8.1. Conclusions

In view of the study findings, several conclusions are hereby noteworthy. There was a positive relationship between banc assurance and financial performance of selected commercial banks in Kenya. This mean that a unit increases in any of the dependent variables under consideration led to an increase in certain number of units in profitability of selected commercial banks in Kenya. This inference was drawn after analysing the respondent responses and using regression to asses' relationships. The study further showed that there was a negative relationship between number of insurance products and financial performance of selected commercial banks in Kenya. The p-value of number of insurance products is greater than significance level of 0.05. This show there is mixed results about the relationships between banc assurance and financial performance of selected commercial banks in Kenya, with both positive and negative relationships. This also point to a non-linear relationship between the two variables.

8.2. Recommendations

The study recommendations to the management of commercial banks in Kenya, Industry regulators in Kenya, Academicians and researchers. The bank management in view of the study, should partner with insurance underwriters who known to be great market players, so as to give their client confidence to take insurance product from the banks as claim will be settled without delays. The management should also know their target market and segment it per product and create a niche for themselves as competition increases. Staff should be trained on handling the new bancassurance segment so that they are able to handle the customers well and efficiently. Finally, management should give all staff all the support they require in adoption and implementation of banc assurance as there is positive relationship between bancassurance and profitability of commercial banks in Kenya.

9. Contributions to Knowledge

The study contribution to knowledge especially to both banks and Insurance companies, is that banks which have not embraced banc assurance, can as well join with insurance sector, to mutually benefit from the union, where by Banks can offer insurance services as agents and get paid commission by insurance companies, who also would get more premiums paid to them through the banks and hence more revenue. The banks will have a better advantage in retaining and even getting new customers because of new products that is available to customers, as one stop shop.

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