
*A marketplace
without boundaries*

&

The future of banking:
A South African
perspective

Contacts

Johannesburg

Jorge Camarate

Partner

PwC South Africa
+27-11-797-4052
j.camarate@pwc.com

Simon Brinckmann

Associate Director

PwC South Africa
+27-11-797-5827
brinckmann.simon@pwc.com

About the authors

Jorge Camarate is a partner with PwC South Africa, based in Johannesburg. He works in Strategy&, PwC's strategy consulting group, leading the financial services practice for Africa.

Simon Brinckmann is an associate director with PwC South Africa, based in Johannesburg. Simon is an associate director in PwC's banking practice.

Contributions:

The authors would like to thank Bernadine Clark, Boitsheko Ganyane and Kwezi Kondile for their participation in writing the viewpoint.

Executive summary



The growth of unexpected players emerging in the financial services industry has created what has been called a ‘marketplace without boundaries’. Non-traditional players are increasingly exploring new opportunities, enabling them to challenge incumbents and continually change the state of financial services in South Africa.

Digital solutions, low-cost operating models and supply-chain integration have moved to the top of the business agenda, with non-traditional players pursuing various aspects of these trends, enabling them to provide their customers with in-house banking solutions.

In response to the growing threat in the retail banking industry, the ‘four universal banks’ (Barclays Africa, Standard Bank, Nedbank and FirstRand) are progressively finding new ways to enable them to stay relevant in the market.

By prioritising key operational trends like digital transformation and data mining, banks can develop solutions to better serve their retail customers and adequately compete with new entrants.

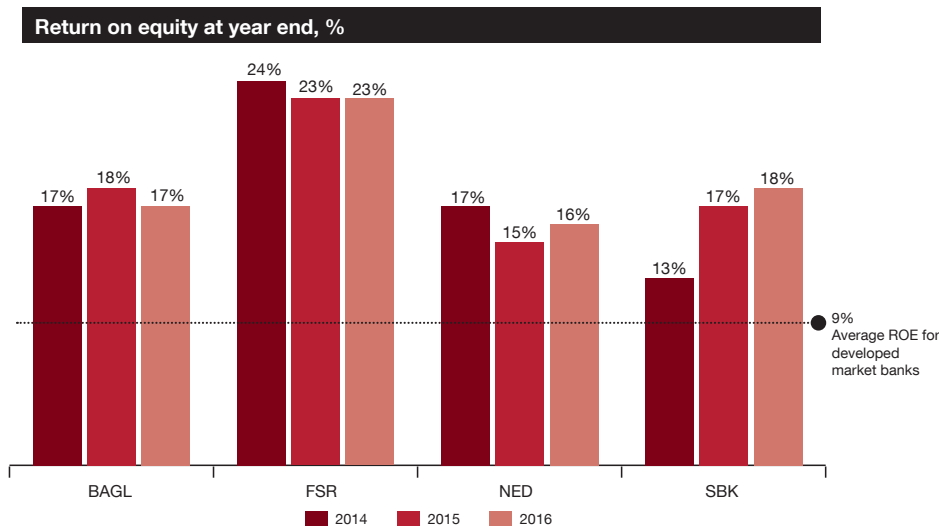
Unlike their challengers, the four universal banks have the principal advantage of being able to serve a sizeable share of South Africa’s business and corporate banking customers. In order to maintain this advantage, they will need to develop strong data analytics capabilities and develop new solutions to better meet the needs of their customers, as well as find efficiencies in their legacy businesses to fund the large-scale transformation effort required.

Trends in the South African banking market

Historically, the South African banking sector has been profitable for the four big traditional players (see figure 1). However, we see three trends developing in the market that could impact the banking landscape as well as the profitability of these banks:

1. The emergence of digital solutions with lower-cost models launched by adjacent financial services players (e.g. Discovery);
2. The emergence of sector and industry-specific banks, closely integrated with broader supply chains, launched by non-financial services players (e.g. South African Post Office); and
3. Ongoing transformation of the four universal banks to address changing customer, regulatory and technology needs.

Figure 1: Big four banks: Return on Equity (ROE)¹



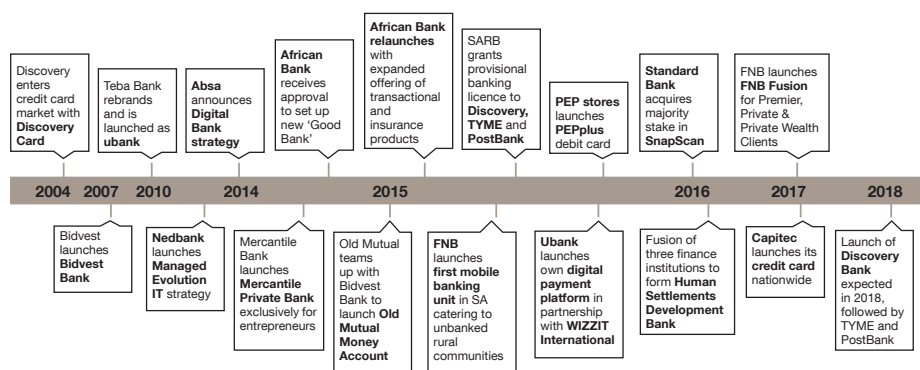
Source: Strategy& analysis

¹ ROE figures presented prior to Nedbank being replaced by Capitec as fourth largest bank by market cap in September 2017

Emergence of digital solutions with low-cost operating models launched by other financial services players

The financial services industry is rapidly evolving towards being a 'marketplace without boundaries'. In recent years, the market has seen other players in the industry diversifying their financial services offerings by introducing digitally-enabled banking solutions to provide better customer experience at a reduced cost (see figure 2).

Figure 2: Recent developments in the South African banking market



Source: Strategy& analysis

Traditionally, insurers and loan providers are known for offering mass-market insurance and finance to individuals and existing businesses. However, the emergence of digital solutions has allowed these financial services providers to reshape their value propositions, and venture beyond the traditional scope of their offerings into the banking market.

In insurance

In recent years, insurers have increasingly shifted toward transactional, lending and savings solutions. Examples include Discovery's credit card facility, Old Mutual's Money Account that doubles as a transactional and savings account, MMI's partnership with African Bank to offer needs-based credit to its customers, and the most significant progression – Discovery's announcement of plans to launch a retail bank, with intentions to compete with the four universal banks.

At a time when the insurance industry is grappling with changing customer behaviours, technological solutions and business models, movements into new markets deliver noteworthy benefits.

Such benefits include the opportunity to capture additional customer-specific data through expansion of the existing client base. This data can be used to improve current loyalty or rewards programmes, drive customer behaviour, improve risk management, as well as increase pricing accuracy. In addition, insurers are able to build platforms to cross-sell adjacent products such as savings and investments.

The financial services industry is rapidly evolving towards being a 'marketplace without boundaries'.

In other financial services businesses

Apart from insurers, we see examples of companies in the lending and wealth businesses that are diversifying their product offering or entering the banking market. An example of this is African Bank², which was always known to specialise in microlending.

In light of its strategy to become a retail bank, African Bank is on track to launch a fully digital, transactional bank account. In a highly-competitive market, African Bank is gearing up to provide its customers with a digitally-enabled bank account, which is competitively priced and offers a great product with additional value-added features.

While the digital platform enables a significantly lower cost to serve and increased cross-selling of additional products, the transactional account proposition would provide African Bank, as well as other lenders expanding their offerings into banking, with a lower cost of funding through secure retail deposits.

Another example is TymeDigital³ (a subsidiary of the Commonwealth Bank of Australia), a South African-based lender that provides customers with the digital systems to access funds through their mobile phones. TymeDigital was granted a banking licence by the Reserve Bank in September 2017 and has partnered with newly-listed investment company African Rainbow Capital. The duo have big plans to disrupt the South African banking industry and help boost lending to the majority of the black population and businesses that have been previously excluded.

In the wealth management segment, Sasfin launched its transactional banking offering two years ago, providing primary banking services to high net worth individuals. These clients deal with the bank directly through its team of dedicated relationship consultants who oversee clients' banking and investment portfolio accounts on a 24-hour basis, as well as its limited network of branches. This move has enabled the company to expand its market share, previously limited by its traditional offerings in wealth and business banking.

Emergence of sector and industry-specific banks, closely integrated with broader supply chain, launched by non-FS players

Non-financial services providers, such as retail and commercial companies, have identified gaps in the financial services market driven by the need for more personalised and affordable offerings than those currently offered by incumbents. This has led to the emergence of non-traditional, sector-specific financial services providers, or banks, as these non-financial services players leverage their sizeable, targeted customer base to fill identified gaps.

² Naidoo, Prinesha. "African Bank moves into transactional banking"; MoneyWeb. 24 May 2017. www.moneyweb.co.za/news/companies-and-deals/african-bank-moves-into-transactional-banking/

³ Bonorchis, Renee. "African Rainbow Capital has eye on banking licence via Tyme stake"; Business Day. 25 August 2017. www.businesslive.co.za/bd/companies/financial-services/2017-08-25-african-rainbow-capital-has-eye-on-banking-licence-via-tyme-stake/

In business banking, discussions between various taxi associations have begun around the potential development of a bank that can provide banking solutions to address growing concerns over high interest rates charged to their member taxi owners. This development could lead to substantial disruption in the banking industry, as it would potentially provide in-demand, targeted offerings to the R40bn industry that requires funding for approximately 1 400 new minibus purchases per month (currently charged interest rates between 16-18.5% above the prime lending rate⁴).

Such cases serve as indicators of the growing wave of non-traditional players realising the advantages of integrating banking as part of their industry supply chain. For example, PEP and PostBank's combined existing real estate network almost equates to that of the four universal banks, and extends to areas where some of the large banks have little to no presence.

Because these distribution channels are already established and far-reaching, they have the advantage of being able to grow a large banking customer base with lower distribution costs than the legacy institutions. In addition to benefiting from low distribution costs, retailers could also bundle their banking products with discounted retail products to offer products and solutions perceived by customers to be of greater value.

Similarly, minibus taxi associations have the scale benefits that allow for lower distribution costs, but also have the advantage of being able to price lending risks better than other financiers given their vast knowledge of the industry and the intimate relationships they have with their members.

Finally, these players are not subject to the limitations of legacy infrastructure, allowing them to easily experiment, through use of technology, options and methods for running much leaner operations that result in lower costs to serve customers. This provides them with an advantage over current, prevailing banking players who, in contrast, have high existing cost bases.

PwC Strategy&'s research suggests that this trend will continue, crossing into other industries as players with sizeable customer bases look for different avenues to grow their share of customer's wallets through competitive banking offerings. *Figure 3* provides additional insight into other non-financial services organisations that have the advantage of a targeted, sizeable customer base that can be leveraged to enter the financial services market.

⁴ Goba, Neo. "Taxi industry aims to be its own bank"; Business Day. 19 June 2017. www.businesslive.co.za/bd/national/2017-06-19-taxi-industry-aims-to-be-its-own-bank/

Figure 3: Potential new entrants into the financial services market

Type	Industry	Potential banking services providers	Current capabilities	Potential financial services solutions
Retail	Retail companies	Grocery retailers (e.g. Shoprite, Pick 'n Pay) Clothing retailers (e.g. Edgars, Jet, Ackermans)	Basic financial services: Cash withdrawals and deposits via tills, coupled with remittances, retail accounts. Customer base: (e.g. 9.8m and 3.6m customers with a preference to shop at Shoprite and Pick 'n Pay respectively)	Transactional banking Personal loans Credit cards
	Large employers	Parastatals (e.g. Eskom, Transnet) Mining companies (e.g. Anglo American, Glencore) Retailers (e.g. Shoprite, Pick 'n Pay)	Customer base: Captive base of employees (e.g. Anglo American and Shoprite employ 150 000 and ±140 000 respectively) with direct access to payroll deductions (provided that employee consent has been received)	In-house personal loan products
Commercial	Automotive	Taxi associations (e.g. South African National Taxi Association)	Customer base: Direct access and service to taxi owners of 200 000 minibus vehicles that are on average nine years old	Vehicle and asset finance
	Agriculture	Agricultural co-operatives (e.g. AFGRI, SENWES)	Credit financing: Currently SENWES undertakes crop financing via a mix of instruments from Nedbank and Absa, but it, as well as other co-operatives, could obtain a licence to reduce their reliance on existing commercial banks Industry intellectual property: partnerships across agriculture value chain, knowledge of best practices and access to markets	Specialist agri-business banking Retail banking for farmworkers and owners
	Property	Large commercial property developers (e.g. Growthpoint)	Industry intellectual property: Partnerships across property value chain and knowledge of best practices	Property finance

Source: Strategy& analysis

Ongoing transformation of the four universal banks to address changing customer, regulatory and technology needs

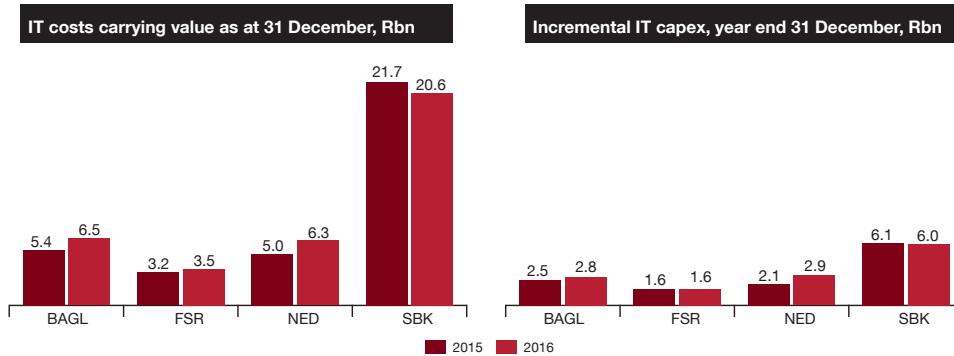
Traditional banks in South Africa are reacting to advancing digital disruption by making substantial investments in digital transformation. This forms part of their strategies to improve risk management, operate more cost-efficiently through reducing and replacing core systems, and enhance client centricity through targeted products and improved on-boarding tools or channels.

Key operational trends include implementation of emerging technologies to evolve or replace legacy systems, a strong focus on cyber and IT resilience, and digitising front and back-office operations, while prioritising fulfilment of customer expectations through electronic channels.⁵

⁵ See PwC's report, "Standing firm against headwinds: South Africa – major banks analysis"; <https://www.pwc.co.za/en/assets/pdf/major-banks-analysis-march-2017.pdf>

Traditional banks in South Africa are reacting to advancing digital disruption by making substantial investments in digital transformation.

Figure 4: Transformation spend of the four universal banks: Capitalised IT cost



Source: Barclays, FirstRand, Nedbank and Standard Bank annual reports; Strategy& analysis

Despite large investments in transformation (indicated by capitalised IT costs [see figure 4]), cost-to-income (C/I) ratios have remained in the 54% to 56% range since 2012.⁶ This trend is not expected to change in the next 3-5 years as specialist resources are employed to assist the banks with transformation, despite banks citing a necessity to bring C/I below 50% in the short term, and aiming toward 40% to remain competitive in the long term.⁷

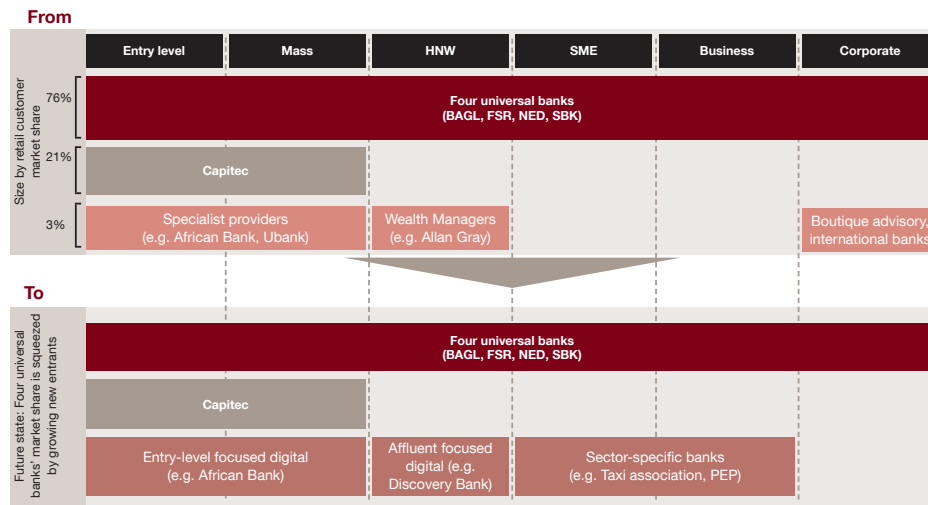
In addition to the slow reaction of C/I to accelerated IT investment, the rate of change driven by these investments may be too slow. For example, the established banks have all launched IT and data transformation projects extending over 5-10 years, but new players are looking at timelines of 12-24 months to launch and finalise new projects, with new features released every 3-6 months. New digital players' ability to easily and quickly launch new offerings into the market strengthens the need for established banks to review the speed in which they launch new products or projects in order to remain competitive.

These trends in the South African banking market are fundamentally transforming the South African banking landscape.

⁶ See PwC's report, "Creating growth despite uncertain times: South Africa – major banks analysis", <https://www.pwc.co.za/en/assets/pdf/south-african-major-banks-analysis-19-september-2012.pdf>

⁷ See PwC's report "Banking in Africa matters: African banking survey"; <https://www.pwc.co.za/en/assets/pdf/african-banking-survey-banking-in-africa-matters.pdf>

Figure 5: Development of the future South African banking market



Source: Strategy& analysis

These trends are fundamentally transforming the South African banking landscape from an industry dominated by four incumbents with segment-specific challengers, to an industry with a variety of competitors capturing a significant share of the value pool across retail and corporate.

The evolution of these trends will undoubtedly result in the market share of the incumbents being squeezed by innovative new entrants, unless the incumbents implement strategies to remain relevant in the future banking market landscape (see figure 5).

What should the four universal banks do?

The changing competitive landscape in the financial industry could have an impact on the profitability and returns of the four universal banks. However, we believe that they can remain relevant and successful in the future by taking decisive actions across their different lines of business.

In retail banking

Accelerate transformation

To stay relevant and engage with consumers in the digital age, traditional banks can accelerate transformation by incubating outside the legacy organisation, leveraging fintech companies or partners and deploying new ways of working (e.g. agile methods encourage employees to work in self-managing, autonomous, multi-disciplinary teams with end-to-end responsibility for delivering on a specific ‘mission’ or project through iterative developmental sprints).

Fintech companies, with their customer-centric approach, agility and technology expertise are perceived to pose a substantial threat to South African banks as new entrants bring more innovative, efficient and cost-effective solutions. These strengths can, however, be leveraged by traditional banks to complement their risk and regulatory expertise, scale and trusted brands.

Adopting effective growth strategies and integrating with fintech businesses will be essential to partnering for innovation. Compatibility between the two can be further supported by the growing emergence of start-up incubators and accelerators set up by banks to explore the spectrum of fintech possibilities. Examples of this include:

- FirstRand’s Alphacode incubator set up to support start-ups that are developing digitally-disruptive technologies;
- Nedbank’s partnership with the LaunchLab, hosting programmes driven by an innovation platform to capture ideas and business models that could potentially disrupt the banking industry;
- Barclays’ Rise Innovation Hub established to provide working space to fintech innovators; and
- Standard Bank’s Open Innovation Lab, which offers access to markets for entrepreneurs that pitch innovative products and/or services to the bank.

We believe the four universal banks can remain relevant and successful in the future by taking decisive actions across their different lines of business.

New ways of working (e.g. agile), used to enhance client-centric operations, drive efficiency and reduce costs, have successfully been implemented in banks internationally. For example, ING in the Netherlands embarked on its journey toward end-to-end enterprise agility by drawing inspiration from tech companies such as Spotify and Zappos to implement agile operating models.⁸ The bank initially launched and tested agile ways of working in operations and IT to shift focus toward delivering on a specific project or ‘mission’. This resulted in quicker reactions to changing client needs, higher levels of responsibility among staff and reduced time spent on interdepartmental meetings and handovers. The successful implementation allowed ING to expand this model to other areas of the bank.

Similar initiatives are beginning to appear in South African banks (i.e. most banks have explored and implemented some form of agile ways of working) and can be accelerated by learning from global examples, where agile methods have proven successful.

It is important for traditional banks to expand IT investment initiatives from building digital tools that may contribute to increased offering complexity toward complete enterprise transformation, focussed on client centricity.

Harness the power of data and existing base

Changing technology has resulted in far more open, modular and capable information systems. For the four universal banks this presents the opportunity to leverage the growing scale and speed of data and analytics to strengthen insights into customer spending habits and patterns. This increases the banks’ ability to proactively cross-sell solutions, as well as identify valuable customers and develop appropriate retention strategies.

Digital solutions, combined with detailed customer insights (e.g. into spending habits) allow banks to build near-accurate pictures of their client’s preferences, and enable the prediction of client risk profiles. These insights can be leveraged to cross-sell convenient, tailored solutions such as pre-underwritten life and short-term insurance, as well as pre-approved loans. An example of this is Absa Life’s development of medical underwriting technology that confidently predicts whether a customer will qualify for life insurance, and generates quotes, by combining customer data with additional questionnaires.

Banks may further benefit from enhanced customer insights by using them to identify high-value customers from loss-making customers, and mould retention solutions or strategies to suit these clients’ profiles. Some examples of retention strategies include using loyalty or reward programmes to increase customer retention. However, traditional loyalty programmes are losing impact and banks are making an effort to provide customers with rewards that are focused on their needs and preferences. In the US, S&T Bank launched its *My Rewards* programme, which is designed to offer personalised cash rewards tailored to each customer’s shopping preferences, be it online or in store.⁹

⁸ “Agile way of working at ING”. ING Nederland. Netherlandshttps://www.youtube.com/watch?v=NcB0ZKWAPA0

⁹ “How banks can increase customer retention with appealing loyalty programs”. ScienceSoft. www.scnsoft.com/blog/how-banks-can-increase-customer-retention-with-appealing-loyalty-programs

In another example, with the aim of attracting and retaining long-term relationships with millennials, Zions Bank developed a campaign called the “Pay for A’s program”. The programme rewards students for their academic performance and dedication and supports education. For every distinction earned, the programme rewards the student with \$1, which is deposited directly into a Zion savings account. Through this programme Zion has been able to attract and retain younger generation’s clients, but also collect data on their spending habits to assist in developing more targeted product and service offerings.

Although these solutions will assist in driving customer centricity, and reducing costs in the long run, the most realistic proposition for many incumbents to remain relevant in the digital age is to develop and launch a radically transformed business alongside their legacy organisations, thus bypassing legacy issues. Although a seemingly simple solution, this proposition runs the risk of creating more complexity in the short term before the benefits of long-term innovation are captured.

In business and corporate banking

Integrate the comprehensive suite of banking solutions to service clients’ entire wallet

One of the core advantages that the four universal banks have over challengers is their ability to meet clients’ full set of business and corporate banking needs. However, to maintain this advantage, banks will need to develop integrated solutions that meet the changing, complex needs of existing and future customers.

For example, integration of cross-border networks, debt financing ability, and transaction processing capabilities can present themselves as an all-in-one solution to local businesses that rely on export markets (e.g. farmers). This will require banks to ‘unfederate’ themselves and break away from product silos, to get a holistic view of their clients. In so doing, banks can improve their client value propositions, increase their share of wallet and drive customer retention.

Increased collaboration between banks to offer more comprehensive products to varied markets is another example of integration aimed at delivering customer value. The formal partnership between the Industrial and Commercial Bank of China (ICBC) and Standard Bank serves as a good example of this collaboration. By combining their expertise of the Asian and African markets respectively they have been able to provide customers with better commercial banking solutions.¹⁰

Develop big data and analytics capabilities

Banks’ abilities to leverage the petabytes of data they have on their commercial customers and markets will become a key differentiating capability to defend and grow their customer base. Big data and analytics can add value internally by equipping relationship managers with the power of deep insights to better serve their current customers. This can be achieved by delivering advice relating to current and potential value

¹⁰ “Standard Bank and ICBC to raise R10 billion to support SA power generation”, Standard Bank. December 2015. <http://corporateandinvestment.standardbank.com/CIB/Latest-News/Standard-Bank-and-ICBC-to-raise-R10-billion-to-support-SA-power-generation>

that customers may gain in their respective markets and the suitability of products they use.

It can also be used externally to empower commercial clients with insights that can help them make better business decisions, and thereby drive retention. For instance, Citibank has been offering its commercial customers transaction data aggregated from its global customer base.¹¹ According to an executive within the bank, these insights were shared with a large Spanish clothing company, which used them to determine where to open new manufacturing plants and outlets.

General Electric is another example of a company that has successfully stepped outside its role as a service provider to become an integral part of its clients' businesses. Access GE, an initiative that was driven by GE Capital in customer-oriented knowledge management, connected their customers with knowledge and expertise from all aspects of GE. Essentially, GE Capital's relationship managers would provide insights to their customers and assist them in formulating methods that would help their companies leverage those insights to their advantage. This contributed to GE Capital's effort to be more than a financial services provider to its clients.¹²

Across the enterprise

As the four universal banks focus on growing capabilities within retail, business and corporate banking to stay abreast of the changing environment, they also need to focus on improving efficiencies of their core legacy systems by funding business and organisational restructuring and building on differentiating capabilities. In summary, they need to become 'Fit for Growth'.¹³

Fit for Growth organisations connect strategy and investment in capabilities with organisational and cultural evolution. This approach observes the company's strategy, clearly articulating the capabilities that really matter to strategy and the ability to win in the market.

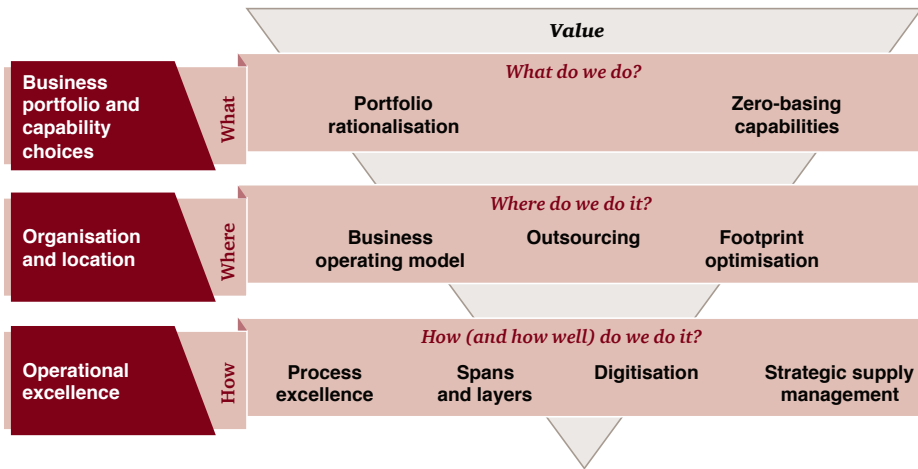
By following this approach, incumbents are urged to focus on identifying key, differentiating capabilities (as previously highlighted); develop a clear cross-organisational cost agenda to identify cost reduction levers (see figure 6); and use the improvements from cost efficiencies to fund investment in the differentiated capabilities being developed in retail and corporate. Lastly, these players should reorganise for growth, to drive sustainability, by implementing an organisational model, processes and systems that unlock potential and agility for growth.

¹¹ "Big Data: How it can become a differentiator". Deutsche Bank. 2014. [http://cib.db.com/docs_new/GTB_Big_Data_Whitepaper_\(DB0324\)_v2.pdf](http://cib.db.com/docs_new/GTB_Big_Data_Whitepaper_(DB0324)_v2.pdf)

¹² In 2015, General Electric announced its plans to sell off most of General Capital's assets. Since then, assets have been sold off to various financial institutions such as Wells Fargo, Blackstone and Goldman Sachs

¹³ Fit for Growth is a trademark of PwC Strategy& LLC

Figure 6: Fit for Growth cost reduction levers to drive efficiencies and free funds for reinvestment in differentiating capabilities



Source: Strategy& Fit for Growth

Typically, Fit for Growth programmes yield savings of between 25% and 30%, but a significant portion of these savings is redirected toward key differentiated capabilities that drive revenue gains. For example, an international wholesale bank determined that it could vastly increase revenue by investing to improve the turnaround time for loans. This outweighed the savings from possible cost cuts in credit risk management by three to one.

In another case, a Fit for Growth programme led a large international wealth management firm to refocus its back-office operations on improving its ability to provide ‘critical moments of truth’ – points in time where an individual experiences joy with the company’s customer experience, feels a connection to that company and, as a result, supports its products or services. This Swiss firm made a relatively modest investment in IT along these lines; customer satisfaction surged and revenue climbed approximately 10% in less than 12 months.¹⁴

Typically, Fit for Growth programmes yield savings of between 25% and 30%.

¹⁴ See Strategy& report, “Is your bank ready for growth? A more strategic approach to costs can help you prepare”, www.strategyand.pwc.com/reports/your-bank-ready-growth-more

Conclusion

The banking industry in South Africa is rapidly evolving as new entrants emerge, client expectations become more demanding and digital innovation swiftly advances. This rapid evolution is reflected in the emergence of low-cost digital solutions launched by traditionally non-bank financial institutions; sector and industry-specific banks, closely integrated with broader supply chains; as well as ongoing transformation of the four universal banks to address changing customer, regulatory and technology needs.

These trends are fundamentally transforming the South African banking landscape from an industry dominated by four incumbents with segment-specific challengers, to an industry with a variety of competitors capturing a significant share of the value pool across retail and corporate banking.

For the four universal banks, this changing landscape presents challenging, but exciting, opportunities to implement strategies to remain relevant in the future market. These include:

- Taking advantage of scale, in combination with data and analytics, to deliver customer-centric products and services;
- Employing capital to boost digital transformation;
- Developing new ways of working by learning from global peers that have proved successful in change; and
- Leveraging established networks and capabilities to deliver end-to-end offerings to high value clients.

They also need to ensure that efforts are focussed on driving efficiency across the entire enterprise in order to effectively fund the capabilities being developed in retail and corporate banking.

Incumbents need to evaluate where they are in this evolving landscape and implement sound, attainable and competitive, client-centric strategies. This will be a challenging task for these banks, but they need to respond quickly or risk their market share being squeezed by new, low-cost, innovative competitors. Those quickest to adapt will benefit from fast-arising opportunities in the future market.

Strategy& is a global team of practical strategists committed to helping you seize essential advantage.

We do that by working alongside you to solve your toughest problems and helping you capture your greatest opportunities.

These are complex and high-stakes undertakings — often game-changing transformations. We bring 100 years of strategy consulting experience and the unrivaled industry and functional capabilities of the PwC network to the task.

Whether you're charting your corporate strategy, transforming a function or business unit, or building critical capabilities, we'll help you create the value you're looking for with speed, confidence, and impact.

We are part of the PwC network of firms in 157 countries with more than 223,000 people committed to delivering quality in assurance, tax, and advisory services. Tell us what matters to you and find out more by visiting us at strategyand.pwc.com.

www.strategyand.pwc.com

© 2017 PwC. All rights reserved. PwC refers to the PwC network and/or one or more of its member firms, each of which is a separate legal entity. Please see www.pwc.com/structure for further details. Disclaimer: This content is for general information purposes only, and should not be used as a substitute for consultation with professional advisors. (17-21204)