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**20 January 2011**

## **Cracking the code: Can the giants win the fight for low-income clients?**

Long after we stopped using the term “New SA”, banks are struggling with the changes brought about by democracy. The extent of the unbanked — estimated to be at least 18m adults — means that a large part of the population remains outside the formal economy, with no access to finance other than the more unscrupulous microlenders.

The big four retail banks — Standard Bank, Absa, First National Bank (FNB) and Nedbank — are only now starting to take this market seriously as their growth opportunities in the formal sector dry up — with limited economic growth and substantial debt pressures on the core middle-income customers. With up to 95% of the retail market held by the big four and Investec, the only other way to grow is to steal market share.

Banking Association head Cas Coovadia says the banks used to operate in a closed economy with no foreign competition. “Banks served the white population, it has taken them a while to understand the mass market.”

The banks are still licking their wounds from the failure of Mzansi accounts, which were rolled out as part of the financial sector charter but have proved unprofitable (see box on page 27).

Standard Bank SA CEO Sim Tshabalala says Mzansi was not used as intended by most clients, who put money into their accounts and withdrew it all immediately. As a result the banks are being forced to become innovative and price competitive to take account of the democratisation of finance. Development strategies are a necessary part of business survival. And banks are not just moving into the entry level market to please the authorities.

A report from researchers Global Insight indicates that there could be 5%/year real economic growth in SA from 2014 to 2039. “This must open up huge potential in the previously unbanked market,” Tshabalala says.

Not that there were no players in this gap: African Bank is the largest lender to people outside the formal banking sector, its average loans are modest by the standards of the big four at just over R7000 (see story on page 30). African Bank does not look like a major threat — with a R24bn loan book it is about the size of Absa’s credit card book.



Ubank has a strong franchise in the mining sector. Workers at most gold and platinum mines have been depositing money into these banks — usually the only accessible branch of any bank onsite — for more than 35 years.

But the real wake-up for the big banks has been Capitec, a share which increased in price by 130% last year. It has capitalised on many of the weak spots of the big banks — expensive transaction charges, short hours and lengthy decision making times. It now has 4% of primary retail bank accounts — excluding Mzansi — which is almost half Nedbank's 8,7%.

With no legacy systems or branches in poorly supported areas, Capitec can be more aggressive in pricing, says Investec Asset Management head of research Chris Steward. "But I expect the big banks will fight back. They can tell clients they cannot expect preferential rates on mortgages or vehicle finance if they move their primary accounts, especially if they move to Capitec."

He says one of the reasons African Bank is not building up a branch network to bring in deposits is that it does not want to be subject to the whims of depositors who can move their money "for rational or irrational reasons".

FNB CEO Michael Jordaan seems quite relaxed about the threat from the second-tier banks. "Competition creates more choice for consumers and stretches incumbents to lift their game. SA actually needs thriving second-tier banks."

Nonetheless, he is the one banking executive who is anxious about the impact of Capitec — he has set up EasyPlan with its own branch network and a lower price structure than the upstart bank. Jordaan says there are independent websites which can confirm its charges.

On the other hand, Absa deputy CEO Louis von Zeuner feels it is not fair to say the big banks have left a gap in the market. "There will always be an opportunity for niche players to compete with us," he says, "as we serve everyone from the most sophisticated corporation needing specialised investment banking down to the simplest retail account."

His concern is what happens when those niche players grow to an optimal size at which point they are compelled to build up an infrastructure and cost base similar to the big banks.

Von Zeuner says Absa is well set up to serve the entry-level market that is growing into the middle market, through small business enterprise finance. It has contact with the market through its Allpay system, which is used to pay out social grants, as well as the best integrated suite of bancassurance products of any SA bank. It has also introduced convenient products for all LSM groups, such as a prepaid debit card linked to specific retailers and coffee shops.

He does not talk so enthusiastically about retail microfinance because of Absa's disastrous foray into the microlending market with Unifer. Since then the big four have become very cautious about microlending.



Absa's losses of more than R1bn in 2002 clearly showed the dangers of inexperienced players entering this risky sector.

Since then Standard Bank ended its joint venture with African Bank in 2006, ostensibly to start a similar product offering. Entry-level customers are, however, still mainly accommodated through Mzansi and E- plan accounts.

There has been political pressure for the banks to serve a broader population. Labour federation Cosatu has repeatedly called for a workers' bank, endorsing ubank as the best bet to achieve this. The ANC is happier to back Postbank. Ubank CFO Jo-Ann Pohl says Postbank is the bank which most squarely competes with it.

Postbank, a division of the Post Office, recently gained legislative approval to become a fully fledged retail bank with its own corporate identity. It still has to apply for a banking licence, but this week ANC secretary-general Gwede Mantashe said with Postbank "the state will have a very visible, big footprint in the financial sector" with 24000 Postbank branches.

Postbank chief operating officer John Wentzel boasts of a 6,2m customer base, though it has no lending products — and this is where the banks make the bulk of their money, provided that the book is well controlled. He argues that the transactional fees for such services as savings and investment accounts are also some of the lowest in the market.

But there is other competition coming with the introduction of the co-operative and dedicated banking legislation. The first will give agricultural co-operatives, stokvels and informal financial businesses the chance to become banks, and the second ring-fences parts of public companies to come into the net.

Coovadia is not convinced these smaller players will give the big banks a run for their money. "In many cases it is best to keep the informal sector informal," he says. "We could kill the existing infrastructure of stokvel savings clubs if we insisted on anything resembling Basel 3 capital requirements. And there are badly administered and managed agricultural co-operatives. I hope it will not be too easy for them to become banks."

Not that the big banks will sit back and watch deposits move away. Ten years ago the solution would have been to set up a separate mass market brand such as Peoples Bank or E-Bank, but Von Zeuner says it doesn't make sense to start up a brand that will immediately be perceived as a second-rate offering.

Retail deposits might not carry high margins, but they are vital as they remain by far the cheapest form of finance for the banks.

Tshabalala says the big banks can offer relevant products to the mass market on a cost-effective basis "but not necessarily through the traditional branch structure. There are many modern delivery channels such as cellphones available to us."



The early cellphone and Internet banks — remember Twenty20 and Red Mouse? — have disappeared. Cellphone banking is reappearing in a different guise. The loudest right now is M-Pesa , a joint venture between Nedbank and Vodacom.

Nedbank CEO Mike Brown stresses that this is a money transfer capability, not a bank account (and certainly not a separate bank). It has a footprint of 2000 outlets. It is a fast and, he insists, safe way to send and receive as well as store money. The FNB eWallet can also be used to store money by people without a bank account, as money is simply sent by SMS to a cellphone.

Brown, and his competitors to different degrees, are increasingly using nontraditional outlets. There is no longer Pick n Pay Go Banking. Its failure surprised many people who thought that of all the retail brands Pick n Pay would have the credibility to make a success of banking. In surveys, the retailer enjoys trust levels way above all the banks. But there are now 85 Nedbank in-retailer stores in Pick n Pay and Boxer, its more downmarket chain.

Nedbank has also built up 320 personal loan stores — only 44 are standalone, the rest in Pick n Pay and Build It stores — which is part of the Cashbuild chain.

The banks have also had to scale back on account fees, for years treated as a cash cow. Nedbank has not changed the cash withdrawal rates at Pick n Pay stores, and for card purchases this year. Brown says the average monthly fee for a current account still remains below 2005 levels compared with other banks, which have raised their charges over the years.

From a regulatory perspective it is a level playing field. Coovadia says there is only one kind of banking licence, and all are subject to the same capital regulations, based on the global Basel regime. "It costs about R350m to set up a bank. We have learnt the lesson from the previous small banks crisis [between 1998 and 2001]."

On that basis clients can be just as confident that their money is safe in any one of the 32 smaller banks as it is in the big four. But unlike the US , there is no national deposit guarantee scheme in SA, so when it comes to risk Standard Bank will ultimately be more attractive than its second-tier rivals.

Capitec, however, has been congratulated by the big four for its timing — bank customers are crying out for simple products with no legacy.

But both Von Zeuner and Tshabalala believe Capitec will get to a point at which it brings more complexity and products into the business.

Quite simply, established bankers believe that at a certain point a niche bank becomes just like any other bank.

"Bankers have been doing the same thing for 3000 years, funding loans with deposits. To make this more effective, we have become giant processors of information," says Tshabalala. Standard Bank, he says, does not compete on price



alone (which is why, unlike FNB, it has not set up a Capitec clone operation) but also on convenience, confidence and trust.

Trust is the area in which the big banks will continue to enjoy a competitive advantage. There is also something aspirational about going to a “proper bank”. But banks will need to pay more school fees as they perfect a mass market model.