A STRATEGIC ANALYSIS OF CAPITEC BANK LIMITED WITHIN THE SOUTH AFRICAN BANKING INDUSTRY

By

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DECLARATION

I hereby declare that the above-mentioned treatise is my own work and that it has not previously been submitted for assessment to another University or for another qualification. I further declare that I followed all the applicable ethical guidelines in the conducting the research.

Signed: **Michael de Lange** Date: **November 2013**

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DEDICATION

This research treatise is dedicated to my late father who tragically passed away last year. He was an inspiration to us all and my hero. Gone but never forgotten. Thank you Dad.

ABSTRACT

The South African banking industry is well regulated and oligopolistic by nature. The financial sector in South Africa is of a world class standard, comparing favourably to that of developed economies i.e. United States of America and Great Britain, and developing economies such as the BRIC (Brazil, Russia, India and China) countries. The South African financial sector possesses the critical elements to exhibit good growth and sustainable profitability.

Capitec Bank Limited revolutionised the banking industry by providing a simplified and cost effective banking solution targeting the masses i.e. the "unbanked" population of South Africa. The company pursued a disruptive innovation strategy by targeting the lower income earning segment of the market i.e. individuals who are employed but do not have a bank account.

Capitec's strategic approach and business model were designed around innovation and technology, exploiting a previously untapped market that no other competitor targeted. This approach has resulted in the bank's phenomenal growth over the past decade and most notably has seen Capitec's return on equity (ROE) increase from 12% to 26% and advances to customers increase from R116 million to R16 billion. This has set a precedent which the big four banks, namely ABSA, First National Bank, Standard Bank and Nedbank, could not match.

Contributing to Capitec's success and the basis on which its business model is built are four pillars: accessibility, simplicity, affordability and personalised service. These pillars have created a competitive advantage resulting in the big four banks playing catch up.

A strategic analysis of Capitec Bank was conducted in order to assess the feasibility of expansion by the bank into Africa. The conclusion of the study indicated that it was indeed a viable option for Capitec to expand its footprint across borders into Africa through mergers with banks exhibiting a similar business model, for example Equity Bank based in Kenya.

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CHAPTER ONE: INTRODUCTION AND RESEARCH OBJECTIVES

1.1 INTRODUCTION AND BACKGROUND

South Africa has a well-developed and regulated banking system which compares favourably with those of industrialised countries (The Banking Association South Africa, 2009). The banking sector has undergone many changes over the last 20 years, with the early 1990s being characterised by a process of consolidation, resulting from mergers between a number of banks, including Allied, Volkskas and United to form the Amalgamated Banks of South Africa (ABSA). The other proposed merger between Nedcor and Stanbic eventually ended in failure (The Banking Association South Africa, 2009).

The promulgation of the Banks Act of 1990 had led to a number of banking licenses being issued and by the end of 2001 there were 43 registered banks in South Africa (The Banking Association South Africa, 2009). Saambou's financial troubles in 2002, however, resulted in a run on BOE and other smaller banks, which led to a number of banks not renewing their banking licenses and others seeking financial assistance from foreign shareholders (The Banking Association South Africa, 2009). Other banks such as Regal Bank also ran into financial trouble at the time and were placed under curatorship (The Banking Association South Africa, 2009).

Although the South African banking sector has been through a process of volatility and change, it has attracted a lot of attention internationally; with a number of foreign banks establishing a presence in the country and others acquiring stakes in major banks (The Banking Association South Africa, 2009). An example of foreign banks establishing a presence in South Africa is Barclays acquiring a major stake in ABSA, and the Industrial and Commercial Bank of China acquiring a major stake in Standard Bank (The Banking Association South Africa, 2009).

The regulatory environment has seen many changes, with many new product offerings as well as an increase in the number of participants. This has resulted in a greater level of competition in the market from smaller banks in the micro-lending

sector such as Capitec Bank and African Bank. These two banks have targeted the low to middle income earning profile, with specific reference to Capitec, which targeted the previously unbanked market (The Banking Association South Africa, 2009).

Currently, the South African banking industry is made up of nineteen registered banks, two mutual banks, thirteen local branches of foreign banks and forty three foreign banks with approved local representative offices (The Banking Association South Africa, 2009).

The financial services sector, which includes the real estate and business services sector, is the biggest contributor to the South African economy. This sector represented about 21.2% of Gross Domestic Product (GDP) during the second quarter of 2010 (The Banking Association South Africa, 2009).

Table 1.1: Individual bank assets as at end of June 2010

Bank	Assets (R'bn)	Market Share
The Standard Bank of SA	781 947 804	25.5%
ABSA	663 076 327	21.6%
FirstRand Bank	578 078 265	18.8%
Nedbank	546 961 735	17.8%
Investec Bank	201 501 528	6.6%
Imperial Bank	57 446 288	1.9%
Citibank N.A.	51 068 333	1.7%
Deutsche Bank	34 910 860	1.1%
African Bank	28 103 931	0.9%
JP Morgan Chase	25 758 392	0.8%
Caylon Corporate and Investment Bank	15 918 044	0.5%
Standard Chartered Bank	13 274 633	0.4%
The Hong Kong and Shanghai Banking Corporation	12 871 226	0.4%
Capitec Bank	10 793 359	0.4%
Societe Generale	8 584 122	0.3%
China Construction Bank	6 524 014	0.2%
Mercantile Bank	5 959 348	0.2%

Source: The Banking Association South Africa, 2009

Table 1.1 above illustrates the individual bank assests as at the end of June 2010. Capitec Bank had assets in excess of R10 billion and a 0.4% market share, as depicted in Table 1.1.

Established in March 2001, Capitec Bank Limited is fully owned by Capitec Bank Holdings and comprises 95% group assets. Founded by CEO, Riaan Stassen, Capitec's ownership structure comprises 24.08% board and senior management, 34.83% the PSG Group, 15.83% BEE Black Economic Empowerment (BEE) groups and 26.26% various other shareholders.

Although Capitec Bank is one of the main players in the South African micro-lending industry and has an estimated market share of 10%, with a 40% share of the one-month loans industry, which is substantial (Haladjian, 2006), it remains a very small financial institution in comparison to the big four banks in South Africa, namely ABSA, Nedbank, Standard Bank and First National Bank (Haladjian, 2006).

Capitec's innovative technology-driven business model is directed at targeting the low to middle income earning profiles of the population. Capitec has strong front-end information technology, including paperless and cashless branches (Haladjian, 2006). It has also strategically placed itself in retailers' premises, resulting in a funds transfer agreement with the likes of Shoprite (Haladjian, 2006). This can be seen as a competitive advantage for Capitec as it allows customers the flexibility to send money to other areas of the country (Haladjian, 2006).

Riaan Stassen, BComm Charted Accountant (SA), has been the chief executive officer of Capitec Bank Holdings Limited since March 31, 2004 and has been the bank's managing director since 2000. Before Capitec Bank, he was the managing director of Boland PKS from 1997 to 2000. Boland PKS was a division of BOE Bank Limited.

Capitec Bank's strategic business objectives are to (Capitec Bank Holdings Limited, 2012):

- Increase market share through an innovative technology-driven banking offer based on simplicity and outstanding service with single facilities through which the individual can service all everyday money management needs, i.e. savings, access to credit and transactions.

- Increase client numbers by facilitating increased accessibility to banking products and services and a transparent and affordable price offer.
- Increase shareholder value by implementing the infrastructure and building blocks required to ensure continued long-term, real growth in assets and profitability. Capitec has realised that quality book growth and cautious bad debt management are the main building blocks in the design of a successful bank.

1.2 RESEARCH OBJECTIVES

The purpose of this research treatise is to conduct ‘’**A Strategic Analysis of Capitec Bank Limited within the South African Banking Industry**’’.

Capitec Bank faces the challenge of growing its client base, business volumes and stable customer deposits in order to build critical mass and compete against the big four banks in South Africa (Haladjian, 2006). It estimates that there are approximately 15 million unbanked South Africans who need a low-cost banking service and product (Haladjian, 2006). The bank has had phenomenal growth over the last decade due to its unique technology-driven business model, as well as the reluctance of the four larger banks to make commitments to this market sector, which is referred to as the ‘’unbanked’’ (Haladjian, 2006).

An analysis of the African continent will be conducted in order to determine whether Capitec’s model will work in the rest of Africa and therefore help grow the bank across borders. Expansion into the African continent could help Capitec become a major player on the African continent, if executed correctly. The company’s unique strategic objectives are aligned with that of Africa’s economy and needs, and in conjunction with its business model, this bodes well for this innovative bank.

Capitec already has plans to internationalise its operations and has appointed Markus Jooste, CEO of Steinhoff International, as a non-executive director (Ventures, 2012). However there is no basis or clear strategic direction yet as to the direction in which the company will internationalise.

1.3 RESEARCH QUESTIONS

In order to achieve the research objectives, the following research questions were investigated:

1.3.1 What does a banking industry analysis reveal about the success of Capitec in the South African banking industry?

1.3.2 What is the strategic approach and competitive position of Capitec in the South African Banking Industry and how does it implement its business strategy?

1.3.3 What is the basis of Capitec's competitive advantage and competitive strategy?

1.3.4 How can Capitec's unique business model be described?

1.3.5 What are Capitec's key success factors (KSF) and how well are these KSF's employed?

1.3.6 Can the strategy employed by Capitec in South Africa be duplicated in the rest of Africa?

1.4 DELIMITATION OF THE RESEARCH

The delimitation of the research reveals how far the research effort extended and where the limits were set. The research study is limited to Capitec Bank Holdings Limited and the South African banking industry. Capitec Bank is an emerging player within the South African banking industry that has targeted the lower to middle income earning segments and the unbanked customers.

The research concentrates on an intensive literature review and an extensive strategic analysis of Capitec was conducted.

1.5 RESEARCH METHODOLOGY

The following procedure was followed in order to formulate the main research objective and research questions. The procedure included a literature review.

1.5.1 Literature Review

The literature review was conducted on Capitec Bank within the South African banking industry, in order to determine its strategic competitive position, its unique innovative business model and how it differs to its competitors, who its key competitors are and what the emerging issues in the South African banking sector are. The research also looked at Capitec's competitive advantage and disruptive innovation strategy and whether this could work in the rest of Africa. The required secondary sources included the following:

- The internet was used to search financial articles and business articles for relevant information
- The internet was also used to obtain Capitec's annual reports

1.5.2 Strategic Analysis

An extensive strategic analysis of Capitec Bank was undertaken to fully understand how the bank operates and what its strategic viewpoint has been in the banking industry. An analysis of its value chain and core competencies was undertaken to determine how these competencies have been translated into a competitive advantage and whether they can be sustained whilst trying to expand at the same time.

The author's own adaptation of Capitec's business model was developed in order to evaluate strategically every element that makes up this innovative bank, as well as to perform a three litmus test in order to analyse Capitec's strategic focus, its ability to be divergent and ultimately to test the effectiveness of the company's strategy. Capitec's rise to success was due not only to its innovative business model but also to its unique value add 'Global One' product. It was imperative to analyse Global One in terms of its innovation life cycle and S-curve. This was achieved by looking at

Capitec's product and process technology strategy, as technology and innovation have been at the forefront of its banking offer.

A feasibility study on the potential expansion into the African continent was also carried out to determine whether the business model would suit the African climate. A case study on Equity Bank Limited was included to evaluate the level of competitiveness within the African banking context and to ascertain what unique position Capitec should take to create uncontested value for the African client base. The case study on Equity Bank also illustrated how practically Capitec could enter into the market as its business model and strategy is very similar to that of Capitec. The study then came to a conclusion about the possible opportunity for a joint venture between Capitec and Equity Bank.

1.6 LIMITATIONS OF THE STUDY

The research study relied heavily on financial and business articles that were published on the internet and information was sometimes questionable in terms of the accuracy of the financial data.

When analysing various articles and case studies that were written by other authors, these information sources only documented what the author thought was relevant and important. This led to information that was not specifically useful for the purpose of this research study.

1.7 SIGNIFICANCE OF THE RESEARCH

The results of this research will attempt to clarify the strategy implemented by Capitec Bank and the reasons for the success of its business model in the South African banking industry. It will also outline future strategies that will help the bank expand across borders into different market segments.

Capitec is relatively new to the sector. Barriers to entry within the banking industry are high and expansion and competition between rivals within the same industry is fierce. In an era where the likelihood of a business succeeding is minimal and

established businesses are under immense strain, Capitec has shown phenomenal growth against all odds.

This research paper will also address issues concerning the strategic direction of Capitec and evaluate the future direction of the company.

In terms of corporate strategy, strategic actions can be used to describe the specific decisions used to support and operationalise the strategic stance of an organisation (Jansen van Rensburg and Venter, 2012). These specific decisions can be categorised as follows (Jansen van Rensburg and Venter, 2012):

- Addressing new markets with the same product, known as market development.
- Addressing existing markets with new products, known as product development.
- Expanding into new markets with new products, known as diversification.
- Moving upstream or downstream in the industry value chain, known as vertical integration.
- Refocusing on core business, i.e. consolidating, for example by unbundling, divesting or cost-cutting.
- Making key changes in staff or structure.
- Responding directly to macro-environmental changes and threats, for example broadening the ownership base in the interest of broad-based black economic empowerment.

1.8 CLARIFICATION OF KEY CONCEPTS

In the context of the research, certain key concepts that relate to the main problem statement will be defined.

Technology-driven business model: Refers to a business model that focuses on innovation and technology. In the case of Capitec Bank, its innovative technology-driven business model focuses on simplicity of transacting and paperless and cashless branches. High levels of technology are prominent in the business model.

Unbanked: Refers to people that have jobs and are receiving an income, but do not have bank accounts. South Africa has a large unbanked population which stood at about 15 million (52% of the adult population) in 2004 (The Banking Association South Africa, 2009).

Low income sector: Refers to people earning below average incomes.

Micro-lending industry: The granting of loans to people who are in need, often poorer people in urban areas and developing countries. The micro-lending industry also grants loans to entrepreneurs and micro-entrepreneurs wanting to start a business.

Front-end information technology: Refers to the advanced forms of technology that are available for the customers and end-users, in the form of paperless transacting and cashless branches, including ATMs and drop safes.

Blue Ocean Strategy: Focuses all of an organisations processes and activities towards a low cost and differentiation strategy, with the goal of making competition irrelevant.

Red Ocean Strategy: Focuses all of an organisations processes and activities towards a low cost or differentiation strategy, with the goal of beating competition.

Competitive advantage: Can be defined as a difference in any organisation pertaining to a certain factor or characteristic that allows an organisation to perform better and better satisfy its customers' needs, thus helping the organisation achieve superior performance (Ma, 1999).

Analyser strategic stance: Strive to minimise risks but at the same time exploit new growth opportunities (Jansen van Rensburg and Venter, 2012).

Defender strategic stance: Strive towards strategic stability (Jansen van Rensburg and Venter, 2012).

Prospector's strategic stance: Strive to enact an innovative and dynamic environment in order to exploit new growth opportunities (Jansen van Rensburg and Venter, 2012).

Reactors strategic stance: Constantly react to changes in the business environment as they do not have proven response mechanisms (Jansen van Rensburg and Venter, 2012).

1.9 CHAPTER OUTLINE

Chapter One deals with the research objectives and the introduction and background of the study. Also included are the main research objectives and research questions, along with delimitations of the research, the significance of the research and the clarification of key concepts.

Chapter Two and Chapter Three comprise the literature review. Chapter Two gives an overview of the South African banking industry by means of an industry analysis. Chapter Three is specifically related to the case of Capitec Bank.

Chapter Four interprets the strategic analysis that was conducted on Capitec Bank within the South African banking industry.

Chapter Five summarises the research treatise and draws conclusions and recommendations.

1.10 CONCLUSION

The aim of Chapter One was to present an introduction to the study by examining the research objective, the research questions, clarification of key concepts and the significance of the study. The research methodology was also briefly explained.
The next chapter presents a literature review of the South African banking industry as a whole.

CHAPTER TWO: LITERATURE REVIEW – SOUTH AFRICAN BANKING INDUSTRY

2.1 INTRODUCTION

The South African banking industry is a highly regulated and well-developed industry, which compares favourably with some of the BRIC (Brazil, Russia, India and China) countries. The South African financial sector can also compete amongst other developed nations of the world such as the United States of America, Great Britain and Germany (Mlambo and Ncube, 2011). The banking industry can be described as oligopolistic by nature as it is dominated by four big banks (Ncube, 2009). The depth of South Africa's financial sector is three times that of India and nearly four times that of Brazil in terms of private sector credit to gross domestic product (Mlambo and Ncube, 2011).

The South African financial sector is dominated by the four big banks, namely Standard Bank, Nedbank, First National Bank and ABSA. These four banks account for over 80% of total assets. The number of banks has decreased from 58 in 2003 to 19 registered banks. This reduction has therefore increased the concentration of the major players in the market. However, due to the introduction of smaller banks targeting the lower income segment, the big four banks are facing more stringent competition. Who are these new players on the banking sector scene? Capitec Bank and African Bank have made tremendous strides over the last decade and have changed the perception of banking within the country.

South African banks are regarded as efficient and profitable. Their net margins have improved over time and their return on equity (ROE) and return on assets (ROA) clearly show that they are profitable (Mlambo and Ncube, 2011). Table 2.1 below refers to their key financial soundness indicators.

Table 2.1: Key financial soundness indicators – South African Banking industry

	2003	2004	2005	2006	2007	2008	2009
Gini Concentration Index	82.9	83.2	83.0	83.1	83.4	84.0	83.6
Herfindahl–Hirschman Index	..	..	..	0.18	0.19	0.19	0.19
Market share of top 4 banks	80.9	83.6	83.8	84.1	85.1	84.4	84.6
Regulatory capital to risk-weighted assets	12.2	13.3	12.8	12.3	12.8	13.0	14.1
Regulatory Tier 1 capital to risk-weighted assets	7.9	9.3	9.0	9.0	9.5	10.2	10.97
NPL to total gross loans	2.4	1.8	1.5	1.1	1.4	3.9	5.9
Return on assets	0.8	1.3	1.2	1.4	1.4	..	0.94
Return on equity	11.6	16.2	15.2	18.3	18.1	28.7	15.8
Interest margin/gross income	38.3	41.6	38.2	43.9	58.5	44.6	49.5
Non-int. expense/gross income	74.8	68.5	61.6	48.4	48.6	42.2	51.1
Liquid-asset ratio	4.7	4.7	4.8	4.6	4.6	4.9	6.3
Liquid assets to short-term liabilities	9.2	9.4	9.3	8.7	8.7	9.8	13.0
Net open position in foreign exchange to capital	0.9	0.9	1.1	1.5	0.7	0.5	0.7
Z-score		3.0	10.9	7.2	8.3	4.2	..

Source: Mlambo and Ncube, 2011

Referring to Table 2.1 above, both the ROA and Z-score declined in 2009, the cause thereof being the global financial crisis (Mlambo and Ncube, 2011). The Z-score measures the amount of risk in terms of the probability of the bank collapsing (Mlambo and Ncube, 2011). Table 2.1 above shows that the financial sector in South Africa is well regulated and that South African banks have been proactive in developing and adopting new forms of technology and best practices, none more so than Capitec with its innovative technology-driven business model.

2.2 STRATEGIC GROUP MAP OF THE SOUTH AFRICAN BANKING INDUSTRY

2.2.1 Key Competitors

Key competitors within the South African financial sector are the four big banks – ABSA, Standard Bank, Nedbank and First National Bank, and more recently the two new smaller banks, namely Capitec Bank and African Bank.

Table 2.2: Low-cost transactional offerings in the South African banking landscape

Brief comparison of low-cost transactional offerings in the South African Banking landscape

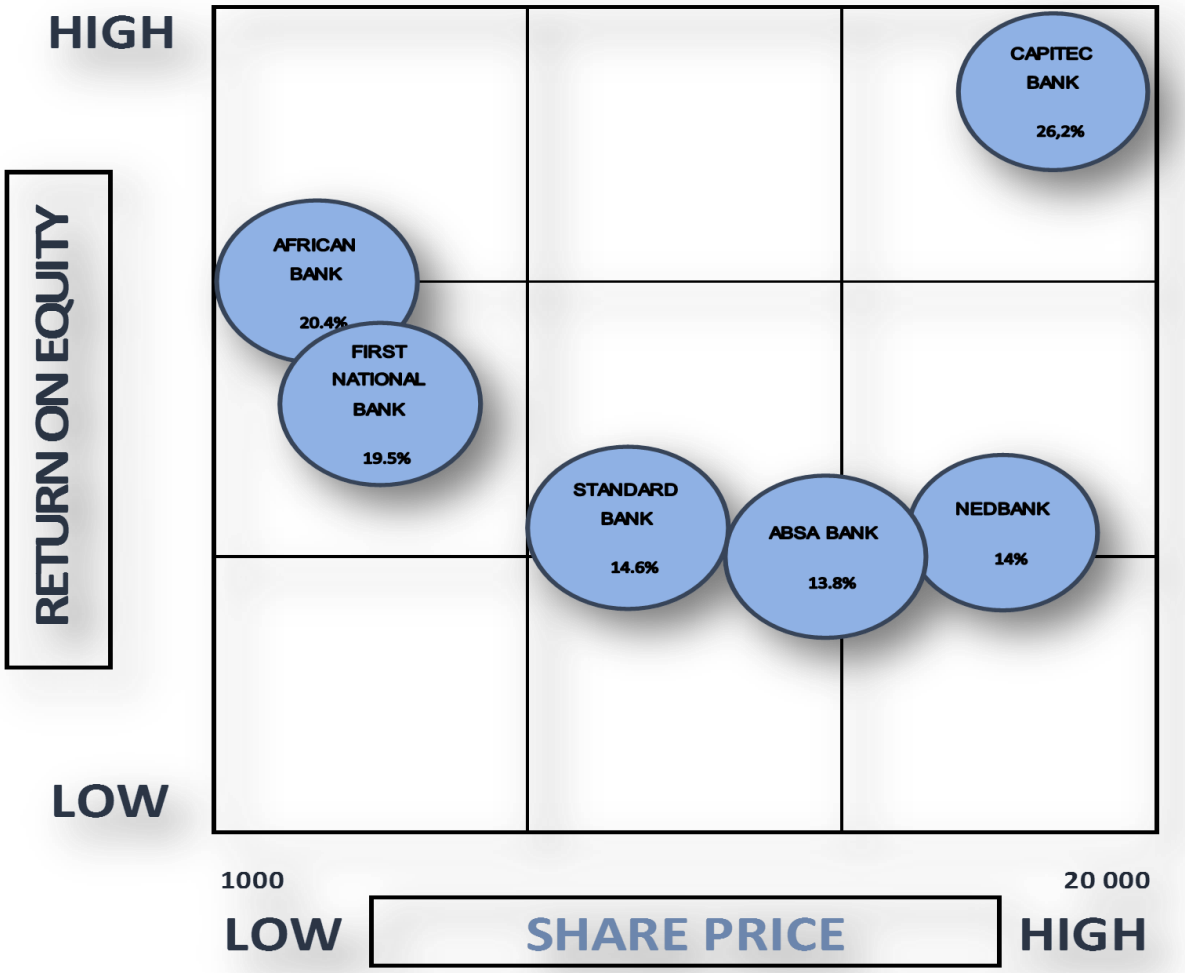
Bank	Access	Monthly Fee	Minimum Deposit	Fee for Withdrawal / Deposit Payment	Sending money via mobile phone	Mobile Banking transaction	Additional Services
FNB EasyPlan	South African ID, Proof of residency	R 3.95	R 10	R 2.95 per transaction		Free to transfer cash R 2.95 per payment for purchasing goods	R1 fee to withdrawal at Pick n' Pay and other retailer shops
Nedbank Ke-Yona	South African ID, No minimum income required	R 5	R 20	R 5 per transaction	R 10 through M-PESA for non-account holders	Activation free	R1 fee to withdrawal at Pick n' Pay (only retailer) R 2000 Funeral cover rolled into R 5 monthly fee
ABSA Transact	South African ID, Proof of residency	No monthly fee if deposit R 2000 per month	R 0	R2.85 Electronic payments/ debit orders R3,85 Absa ATM withdrawal		Available	Prepaid electricity/airtime can be purchased
Capitec	South African ID, Proof of residency	R 4.50	R 10	80c per R100 Deposit R4 withdrawal at Capitec ATM 7 Other ATM	Not available via mobile phone	Activation free R 1.50 to make payment to Capitec bank account	R1 fee to withdraw at Pick n' Pay and other retailer shops Free prepaid purchase of airtime/electricity on mobile/card
Standard Bank AccessAccount	South African ID	R 0	R 0	R 0 for deposit, 1% for withdrawals	R 9.95	R 2	R 2

Source: www.bsa.co.za, www.fnb.co.za, www.capitecbank.co.za, www.nedbank.co.za, www.standardbank.co.za

Table 2.2 above gives a brief summary of the products and low cost offerings of some of the major competitors in the banking landscape.

A strategic group map consists of industry members with similar competitive approaches and positions in the market. These similarities may include price/quality range, distribution channels and product line breadth (Hough et al., 2011). The South African banking landscape contains several strategic groups and the players and can be differentiated by their target market and product offerings. This is, however, changing rapidly, with a blurred line between traditional full spectrum banks and the smaller banking institutions, which are attempting to increase their market share. A strategic group can also be defined as ''the group of firms in an industry following the same or similar strategy along the strategic dimensions'' (Papercamp, 2011).

Figure 2.1: Selected strategic group map of the banking industry



Source: Ashton, 2013

Figure 2.1 above shows the ROE against share price for the main banks. The process of loans is easy and quick within the micro-lending industry. Hence we see that Capitec Bank has a high ROE as well as a high share price. The share prices and ROE of each of the banks in Figure 2.1 above can be depicted in Table 2.3 below:

Table 2.3: ROE and Share Price Data in the banking industry

Company	Share price	12-month PE	P/BV	ROE
Nedbank	18154	10.0	1.62	14.1%
Standard Bank	10955	10.5	1.64	14.6%
ABSA	14077	9.1	1.57	13.8%
FirstRand	2738	10.7	2.60	19.5%
African Bank	3180	7.3	1.84	20.4%
Capitec Bank	20750	12.3	4.04	26.2%
Average of Big 4:		10.1	1.9	15.5%
Capitec premium to Big 4:		1.22	2.18	1.69

Source: Ashton, 2013

2.3 INDUSTRY ANALYSIS

2.3.1 Introduction

An industry analysis is important in order to understand the climate in which a business operates. It provides an overall assessment of strengths, weaknesses, opportunities and threats within a specific sector as well as political, economic and other important market related factors which influence a business.

Another reason why an industry analysis is of such great importance is that it provides an in-depth examination of the threat of new entrants into a market, the threat of substitute products, barriers to entry and the bargaining power of suppliers and customers. Conducting an industry analysis allows a company or business to understand the overall market within which it operates.

2.3.2 Environmental Analysis of the South African banking industry

In order to draw conclusions and to critically analyse the environmental landscape of the South African banking industry, a PESTLE analysis was conducted.

PESTLE is an acronym for “Political, Economic, Social, Technological, Legal and Environmental” and is an industry sector analysis which is used to determine certain factors affecting an industry and the competitors within that industry. Below is a PESTLE analysis focusing on the South African banking industry (Papercamp, 2011).

- **Political / Legal:** The political and legal factor is a very important variable for any industry as there are always certain legal parameters or boundaries implemented by government which affect the industry. The banking industry is no exception. The Financial Sector Charter of 2004 is a prime example of such parameters. This charter was an agreement of service provisions and empowerment targets aimed at ensuring access to transaction and savings products for the poor population in South Africa. Due to the difficulty in obtaining credit in South Africa, the National Credit Act of 2006 was implemented by government to allow the low income earning segment access to credit.
- **Economic:** There is a big gap between the poor and wealthy in the South African banking industry. The difference between the poor and wealthy is that the middle to upper income earning segments are able to invest their money for longer, whereas the low income earning segments have to save a portion of their income instead of investing it (Cameron, 2011). Traditionally in South Africa, the big four banks developed business models that worked against the low income earning segment, leaving a market waiting to be tapped.
- **Social:** As mentioned above, traditionally the banking industry in South Africa favoured middle to upper class customers. The lower class, commonly referred to as unbanked, worked with cash in hand. Due to improvements in the social well-being of the low income earning segments and improvement in housing development and availability of electricity, this market began to develop (Papercamp, 2011). Capitec subsequently tapped into this market with its unique business model.
- **Technological:** Advancements in technology play an ever increasing role within the financial sector, not only in South Africa, but worldwide. The big four banks in South Africa, due to their size and established market presence, have access to the necessary funds and resources to invest in the newest and latest technology that can give them a competitive advantage (Papercamp, 2011). The smaller banks, such as Capitec, had to devise strategies to match the technology of their competitors, but in a cheaper more cost effective package. How did Capitec achieve this? It made use of paperless and cashless transacting and front-end information technology using magnetic strip and electronic smart cards (Papercamp, 2011). The bank

also aligned itself strategically with leading retailers such as Shoprite and Pick ‘n Pay, in order to streamline its distribution channels. Capitec customers can therefore draw money from these retailers – another differentiation strategy (Haladjian, 2006).

- **Environment:** These factors do not have a bearing on the banking industry.

The most important factors in the banking industry, social and technological factors, are also the driving factors of Capitec’s business model and value add. Government imposed legislation does, however, have a bearing on the industry sector (Papercamp, 2011).

2.3.3 Porter’s Five Forces Model

In order to conduct a strategic and critical analysis of the banking industry, an analysis of the competitive landscape is vital. Porter’s five forces is an excellent tool to determine where the power lies in a particular industry and at the same time it provides a model or framework to develop a tailor-made business strategy for analysing the competitors in the industry.

Developed by Michael E. Porter, Porter’s Five Forces is used to analyse a company’s competitive industry environment. It diagnoses the principal competitive pressures in a market and at the same time it assesses the strength of each force and the importance of each of the five forces (Hough, et al., 2011).

The South African banking industry has already been established as oligopolistic and dominated by the big four banks.

- **New Entrants**: The banking industry has high barriers to entry; therefore the threat of new entrants is relatively low. The threat of new entrants is therefore considered a weak force.
- **Suppliers**: This is a strong force and poses a threat. Banks require capital in order to extend their credit facilities and lending capacity. A lack of capital will negatively influence a bank’s ability to lend or borrow money and will negatively impact the interest earned by the bank (Papercamp, 2011).

- **Industry Competitors:** This is a strong force as competitor rivalry is high within the banking industry. Competition is fierce due to the big four banks offering similar products to Capitec. At the same time Capitec is trying to alter its product range to emulate the big four banks (Mittner, 2012).
    - **Nedbank**: has been slower than the other big banks in South Africa in terms of product and application offerings to its customers (Clark, 2012). However, the bank has promised many new offerings this year, rolling them out one by one, which Nedbank refers to as the new secure digital ''highway'' (Clark, 2012). Nedbank plans to fire new applications in rapid succession and to ''leapfrog'' some of its competition at the same time. Nedbank is promising its customers improved security and this new technology ensures out-of-band authentication which limits access to fraudsters who can get into accounts with phishing attempts (Clark, 2012).

      Nedbank is also planning to launch another offering to its customers that forms part of the suite, a financial planning application referred to as ''My Financial Life'' (Clark, 2012). This application will work on both smart phones and feature phones. The authentication process will not just happen through a password but through a new system which integrates the use of a password and an e-certificate, making it much more secure. The bank is also in the final stages of obtaining Apple accreditation for the new application.

      Nedbank believes that it has a competitive advantage over its competitors as it will take time for the other banks to follow the true out-of-band authentication (Clark, 2012). Nedbank can't play catch-up, but it can leverage itself in the mobile application space as a strategic driver (Clark, 2012).
    - **First National Bank**: is the only bank to take on Capitec by offering a minimal infrastructure, low fee front (Laing, 2012), in other words, a Capitec clone referred to as the FNB EasyPlan (Laing, 2012). FNB is attacking Capitec head on by offering its ''cashback'' fee (withdrawing at retailer tills instead of ATMs) at 90 cents which is 10 cents cheaper

than Capitec. However, Capitec retains a price advantage by offering free debit card transactions in comparison to FNB's EasyPlan which costs R1.

FNB's EasyPlan monthly fees are R30.18 compared to the monthly fee of R35.75 charged by Capitec. Both are considerably cheaper than Nedbank's fee of R65.78, ABSA's fee of R87.72 and Standard Bank's fee of R92.85, for the same basket of transactions (Laing, 2012). However FNB's traditional cheque account fees look rather inferior when compared to its EasyPlan option.

While cutting EasyPlan fees to match or beat Capitec fees, FNB has introduced new fees to its traditional accounts to force older, cheque-writing customers to go electronic (Laing, 2012). The other big banks have steered clear of the price war between Capitec and FNB's EasyPlan by charging the same hefty fees (Laing, 2012).

FNB has pursued a different strategic approach to Capitec's no frills banking by saying the complete opposite, that "the frills are worth it'' (Laing, 2012). Capitec's pay-as-you-go may well be cheaper than FNB's R59.99 smart account bundle, but FNB's package includes a R10 000 funeral policy (Laing, 2012).

All these add-on's might attract new customers but at the same time deter customers who want the simplicity and transparency of Capitec Bank.

- **ABSA**: launched the ''Transact'' account in order to increase its unbanked market in South Africa (Blakey, 2012). The Transact product will feature no penalty fees, no charges for point-of-sale till transactions, no charges for balance enquiries and no charges for airtime top-ups (Blakey, 2012).

Depending on each individual's banking behaviour, charges will be very cost effective as the charges will be based on a pay-as-you-transact basis. Till point withdrawals will cost R1 per transaction, electronic payments and debit orders will cost R2.85 and an ATM cash withdrawal will cost R3.85 (Blakey, 2012).

ABSA launched the Transact product in order to combat Capitec's Global One and FNB's EasyPlan (Blakey, 2012).

- **Standard Bank**: announced a new product offering cost savings of up to 50% or more on banking fees, making them the most competitive bank in South Africa (Steyn, 2012).

  The new product range starts with the Access account at no monthly fee and each customer pays per transaction or R30 per month for a bundle of transactions (Steyn, 2012).

  Standard Bank claims to have the best offering on the market and will introduce customer reward schemes that are cost effective (Steyn, 2012).

- **Buyers**: Customers at the lower end of the income earning segment are a weak force in the banking industry. There will always be a market for the unbanked; customers are therefore entitled to a certain standard of service. The Capitec business model is attractive to the unbanked customer as it rests on four main principles, namely simplicity, affordability, accessibility and personalised service (Papercamp, 2011).
- **Substitutes**: These provide a moderate force to the industry (Haladjian, 2006). What counted in Capitec's favour was the fact that the four big banks were not strong in differentiating their markets. All of the four big banks launched new products aimed at the lower end of the market: FNB's EasyPlan, Nedbank's KeYona, Standard Bank's Access account and ABSA's Transact (Papercamp, 2011).

Another reason for substitution being a moderate threat is the fact that Capitec's fee structure is affordable and easier to understand and a standard rate applies to all customers. Fees charged by other banks have a more complex structure and are more expensive (Papercamp, 2011).

According to Porter's five forces model, the South African banking industry is attractive, with high barriers to entry, and there will always be a market for the unbanked. Although competitive rivalry is high, cost and fee structures differentiate one bank from another, making Capitec an attractive option (Papercamp, 2011).

Since Capitec is a relatively new competitor within the banking industry, it is able to analyse the banking industry more critically and develop a strategic model which better suits the current South African climate. With high barriers to entry within the market, the threat of new entrants is low and the banks which have already established themselves within the industry need not concern themselves with the threat of possible new entrants.

2.3.4 SWOT analysis of the banking industry

SWOT analysis is an acronym for analysing a company's internal strengths and weaknesses and its external opportunities and threats. In this case an industry SWOT analysis will be conducted on the South African banking industry. It is a very powerful tool that can be used to assess the overall health and well-being of the financial sector in South Africa. A SWOT analysis allows for relevant decision-making within any business situation or industry. A SWOT analysis also helps to clarify strategic objectives by identifying weaknesses and strengths and building on both by highlighting the various opportunities identified in the analysis.

Strengths:

- South Africa has a relatively large, well-regulated financial sector. The South African banking industry can compete against the most developed nations of the world.
- Since the beginning of democracy in 1994, the government of South Africa has pursued a prudent fiscal policy and the implementation of an inflation-

based monetary policy by the South African Reserve Bank has won the confidence of financial markets (Coppock, 2008).

- South Africa's growth in total assets and loans is larger than that of most developing countries, except for Russia.
- It has a well-developed financial infrastructure in relation to per-capita income.

Weaknesses:

- Unemployment remains a big problem and will affect South Africa in the future (Coppock, 2008).
- Low per capita incomes and high taxation rates will affect and reduce market attractiveness within South Africa's financial sector (Coppock, 2008).
- Currency fluctuations and a volatile Rand have placed the financial sector under undue stress (Coppock, 2008).

Opportunities:

- A weaker currency will increase the opportunity for exporting and will also allow organisations in South Africa to compete more effectively against imports into the local market (Coppock, 2008).
- An increase in the long term growth rate is vital to alleviate unemployment and poverty. Skills training is therefore a massive opportunity (Coppock, 2008).

Threats:

- The threat of HIV/AIDS and its impact on long term growth is still a major concern. It will require a significant increase in fiscal spending (Coppock, 2008).
- Black Economic Empowerment (BEE) will cause an increase in compliance costs over the short term. It should, however, increase participation and ownership of financial resources over the long term (Coppock, 2008).
- Corruption and bureaucracy within the South African government (Coppock, 2008).

2.4 STRATEGIC STANCE AND ACTIONS OF THE MAIN PLAYERS IN THE BANKING INDUSTRY INCLUDING CAPITEC BANK

2.4.1 Introduction

As mentioned previously, South Africa has a well-developed financial sector and the main players within the banking industry are referred to as the big four, namely ABSA, Standard Bank, First National and Nedbank. New entrants such as Capitec Bank and African Bank are proving to be more of a threat every year. The strategic stance and actions of each of the main players is analysed and discussed below.

2.4.2 ABSA

ABSA's strategic stance can be described as defensive, with a cautious approach to new investment growth (Jansen van Rensburg and Venter, 2012). As mentioned previously, ABSA is one the big four banks in South Africa, offering a broad range of products.

Its strategic stance can be described as (Jansen van Rensburg and Venter, 2012):

- Defending its position as a market leader in retail banking Expanding and maintaining its footprint across Africa using South Africa as a base.
- Diversifying its income base to non-retail income sources.

Its strategic actions are:

- Market development in order to enter the lower income earning segment as Capitec has done.
- Product development.
- Forward integration in order to provide risk management services.
- Strategic alliances in order to leverage Barclay's Bank's involvement.

2.4.3 Capitec Bank

Capitec's overall strategic stance is that of a defender, focusing on a narrow niche, the low income earning segment and the unbanked. It is, however, showing signs of moving into the higher income earning segments in order to compete with the four big banks.

Its strategic stance can be described as follows:

- Good customer service to a narrow market segment by providing the basic banking services and being transparent.
- Due to a majority of its customers coming from the low income segment, location is vital. Capitec therefore places an emphasis on locating itself near its customers.
- Promoting the use of technology to make banking simpler and more affordable.

Its strategic actions can be described as follows (Jansen van Rensburg and Venter, 2012):

- Extremely cost conscious and transferring this philosophy of cost saving to its customer.
- Very limited product range while providing the best value add to its customers.
- Organic growth through growing distribution channels, retailers, branches and ATMs.

2.4.4 Nedbank

Nedbanks' overall strategic stance is that of an analyser (Jansen van Rensburg and Venter, 2012). It provides a full range of banking services, like ABSA, but with a strong emphasis on quality transacting.

Its strategic stance can be described as follows:

- A focus on culture as its competitive advantage.
- Transformation following a conservative approach with a long term view.
- Strong emphasis on the brand.

- The goal of being Africa's most admired bank.

Its strategic actions can be described as follows:

- Strategic alliances in order to increase its footprint on the African continent, for example partnering with Ecobank.
- Unbundling of business banking to act as a standalone business.
- Product expansion and development through non-interest revenues, for example wealth management.

2.4.5 Standard Bank

Standard Bank has a dynamic strategic stance, constantly looking for new opportunities to grow and expand the organisation. It can be characterised as an analyser (Jansen van Rensburg and Venter, 2012).

Its strategic stance can be described as follows:

- Strong focus on the BRIC countries and the rest of Africa, replicating its capabilities in emerging markets.
- Value chain focus.
- Its strategic alliance with ICBC China is seen as an opportunity to expand internationally.

Its strategic actions can be described as follows:

- Product development as Greenfield investments.
- Focus on new product offerings in the low to middle income earning segments and previously unbanked.
- Organic growth of business volumes and a strong focus on international expansion via partner alliances.

2.4.6 First National Bank

FNB is characterised as a prospector. It is constantly innovating and searching for new opportunities to expand (Jansen van Rensburg and Venter, 2012). FNB's

business model is described as a federal model of managing a diverse portfolio of businesses through the life cycle (Jansen van Rensburg and Venter, 2012).

Its strategic stance can best be described as follows:

- Owner-manager culture, slowly transforming to a professional manager culture.
- Huge emphasis on innovation, technology and entrepreneurship.
- Emphasis on Greenfield investments instead of acquisitions.
- Strong focus on emerging countries in Africa, India, China and Brazil.

Its strategic actions can be best described as follows:

- Aggressive organic growth of existing businesses.
- Focus on empowerment in the financing market.
- Product development in the form of Greenfield investments.
- Restructuring and unbundling of successful businesses such as Discovery and Momentum.

2.5 CONCLUSION

Although highly regulated, the South African banking system has gone through dramatic changes over the past two decades (The Banking Association South Africa, 2009). The banking system is viewed as world class, with adequate capital resources, infrastructure and technology and a strong regulatory and supervisory environment (The Banking Association South Africa, 2009).

However, as with most countries across the globe, South Africa was affected by the financial crisis in 2008/2009, which affected customers' spending patterns and resulted in a reluctance to take on more debt (The Banking Association South Africa, 2009). The result was an increase in non-performing loans, which had a tremendous impact on the bank's loan books (The Banking Association South Africa, 2009).

Lastly, due to the implementation of the Financial Sector Charter (FSC) in 2004, there have been a number of emerging players in the banking industry, none more prominent than Capitec Bank. These small players have created competition for the big four banks by targeting the unbanked population in South Africa. Capitec has taken advantage of this by focusing on entry level, basic banking functions.

Chapter Three will provide a literature review of Capitec Bank, looking at the history and background of the bank, the business model that helped them enter an emerging market like South Africa as well as its ownership structure.

CHAPTER THREE: LITERATURE REVIEW – CAPITEC BANK LIMITED

3.1 INTRODUCTION

Capitec Bank is a unique and innovative bank that focuses on simplified, technology-driven solutions to retail banking in South Africa. It has changed the banking industry in South Africa since its inception in 2001. More than 2.5 million customers have joined Capitec since 2001 after it pursued a blue ocean strategy to target the lower-middle income retail banking market (Pitman, 2011). A blue ocean strategy, or disruptive innovation, is a strategy aimed at creating a new market that is uncontested, thereby making any form of competition irrelevant and at the same time creating a new demand by way of low cost and differentiation. Capitec was named, along with 26 other brands including Facebook, Apple, Hyundai and Uniqlo, as one of the global 'great brands of tomorrow' by Credit Suisse, a Swiss-based financial group. This made Capitec the only African brand to have made it onto the list (Cherry, 2010).

The success story of Capitec is a story of disruptive thinking in action, of the new kid on the old block who took a gap that others saw but were unable to fill (Pitman, 2011). In identifying and filling this gap, Capitec showed up the other major banks in South Africa at a time when they seemed entrenched as market leaders. Although Capitec has not yet dethroned any of the major banks, it has certainly raised a few eyebrows and has made them sit up and take notice (Pitman, 2011).

Over the last decade, Capitec has created quite a stir in the banking industry. When it was listed on the Johannesburg Securities Exchange in 2002, its shares were listed at R1.17 per share. Today they are valued at R230 per share – phenomenal growth in such a short time span (Pitman, 2011). It is a success story to take note of and one which future entrepreneurs can learn from.

Capitec Bank is South Africa's first retail bank in years and it has cornered the huge lower-middle income retail banking market, signing an average of 70 000 new

customers a month (Pitman, 2011). It has an aggressive strategy to grow the business by 55 branches a year over the next five years. This is cause for concern for the four big banks, whose position remained unchanged for years before Capitec came along.

This chapter covers theoretical research on the banking industry, which was undertaken with specific reference to Capitec Bank. A literature overview is given on the history and background of Capitec, as well as the unique technology-driven, innovative business model that it uses against its competitors. Capitec's strategic approach is analysed as well as its competitive advantages. It also includes an in-depth look at its success factors, along with the sustainability of its competitive advantage and the environmental factors that play a pivotal role in the success of Capitec's unique business model within the African context.

3.2 HISTORY AND BACKGROUND OF CAPITEC BANK LIMITED

This research examines Capitec Bank, which started out as a number of independent micro-lending institutions, largely focusing on consumer finance (Coetzee, 2003). This collection of micro-lenders was merged into one institution and further developed into a licensed commercial bank listed on the Johannesburg Securities Exchange, hereafter referred to as JSE (Coetzee, 2003).

When the bank opened its doors in 2001, it could not obtain a R100 000 loan from financial institutions to buy a motor vehicle. Today it has about R3 billion in surplus funds invested with those very same financial institutions (Cameron, 2011). It is rapidly expanding its product range to include savings and the financing of small, medium and micro enterprises (SMMEs). The success of Capitec is a story of institutional growth, formalisation and the development of products which provide customers with what they want, where they want it (Coetzee, 2003).

Capitec Bank is a proudly South African owned bank or microfinance institution, specialising in providing a full range of financial and banking services to a customer base that has been referred to as the unbanked customers in South Africa (Coetzee, 2003). These customers are often previously disadvantaged and

are part of the low to middle income groups Capitec's customer base has been profiled in the Living Standards Measurement classification system (LSM) as 4 to 7, which means formally employed males and females between the ages of 20 and 49 with an average annual household income of R17 628 to R87 540. Capitec's emphasis since its establishment has been that of innovation in the corporatisation process rather than outreach and sustainability (Coetzee, 2003).

The establishment of Capitec took place at a time when two other South African financial institutions or microfinance institutions were collapsing, resulting in low confidence among investors and depositors (Coetzee, 2003).

Capitec is a subsidiary of PSG Financial Services with PSG Group Limited (PSG) being the holding company. This is listed on the JSE. The microfinance business was identified by PSG and a number of businessmen based in Stellenbosch as a viable sector in the financial services market. They recognised this as a viable sector because of the large number of viable smaller microfinance institutions existing at the time and the inability of the major commercial banks to meet the demands of this market (Coetzee, 2003).

PSG entered into the low income-lending market in 1998 via the acquisitions of two micro-lending institutions in Johannesburg. The book value of these two institutions was less than R1 million. During this time a business called Anchorfin was established, aiming at the payroll deductions market. Subsequently a holding company by the name of Keynes Rational Limited was established in order to manage Anchorfin (Coetzee, 2003).

During the latter half of 1998, a decision was made to expand into the short-loans sector; Finaid Financial Services (Pty) Ltd was purchased with a book value of R13 million per month and numerous branches across the country. At the time, Anchorfin had 700 agents and the existing business had 12 branches (Coetzee, 2003). During the early stages of 1999, growth in the company flattened and a new strategic approach to expand by way of acquisitions was adopted.

This new strategy was devised due to concerns over the exposure to the payroll deductions of government employees. A decision was made to dispose of Anchorfin. The new strategic approach paved the way for the purchase of 270 branches from September 1999 to 28 February 2001. The monthly book value grew from R13 million to R75 million (Coetzee, 2003). On the operational side, the number of employees increased from 50 to 1301 by the end of February 2001.

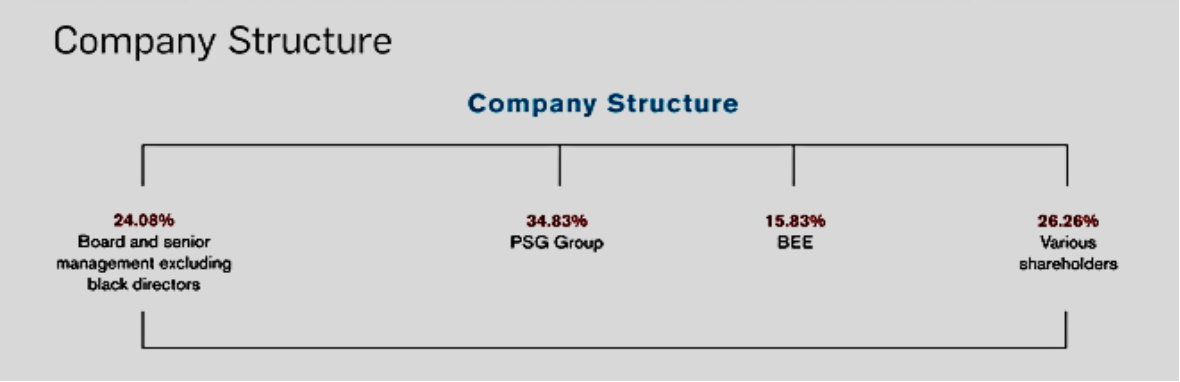
During 2001, Keynes Rational Limited began to narrow its focus to banking services, and thus the decision was made to focus primarily on the lower income sector of South Africa, collectively known as the unbanked customers. The aim was to provide individuals and small businesses with a range of banking facilities that were economical as well as affordable. These services were based on individual needs and risk profiles, taking cash flow and ability-to-pay-models of risk evaluation into consideration (Coetzee, 2003).

Acquiring a banking license and increasing share capital became both a necessity and a priority. Keynes Rational Limited therefore applied for a banking license and this led to the restructuring and incorporation of Keynes Rational Limited into The Business Bank Limited (TBB) on 1 March 2001. TBB was a subsidiary of PSG Investment Bank Holdings Limited. TBB was then changed to Capitec Bank Limited and Keynes Rational was renamed Capitec Bank Holdings Limited in February 2002. Capitec was listed on the JSE on 18 February 2002 (Coetzee, 2003).

3.3 CAPITEC BANK LIMITED'S OWNERSHIP STRUCTURE

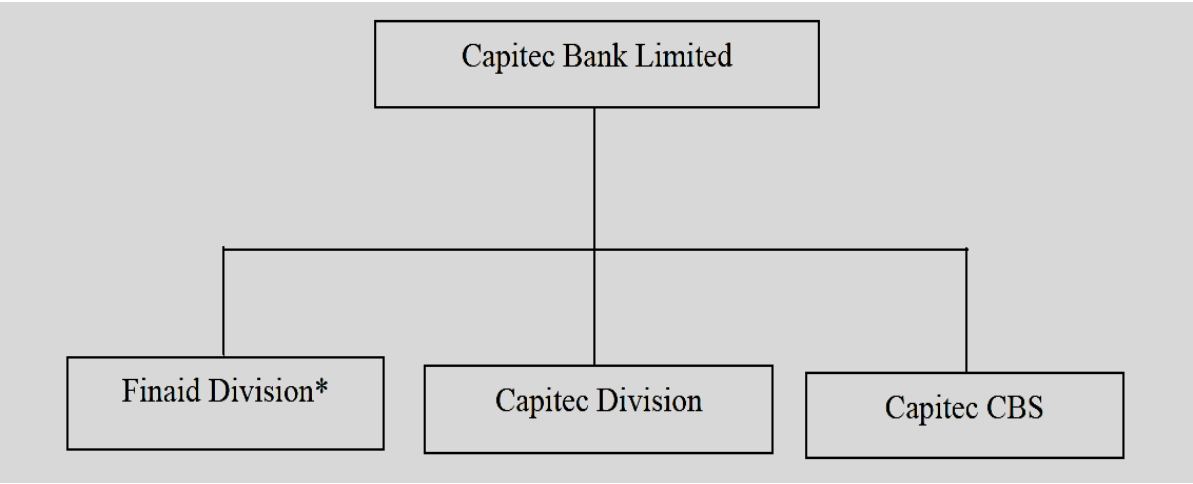
Figure 3.1 below refers to the group structure of Capitec, while Figure 3.2 depicts Capitec's bank divisions.

Figure 3.1: Capitec Bank Holdings Limited structure



Source: Capitec Bank, 2013

Figure 3.2: Capitec Bank Divisions



Source: Coetzee, 2003

Capitec Bank Limited consists of three divisions, as depicted above in Figure 3.2.

- **Finaid Division** – focuses primarily on short-term microloans to customers falling within LSM 3 to 5 income earning profiles (Coetzee, 2003). The customers that fall into this category are individuals that may have savings accounts but are unable to obtain traditional bank loan finance (Coetzee, 2003). Terms of the loans granted is 30 days and the amounts vary up to R10 000, but seldom exceed R2500. The interest rates vary between 21.5% and 30% per month, depending on branch history (Coetzee, 2003). However, due to the success of the Capitec branches, a decision was made to do away with the Finaid brand and change the Finaid branches to the Capitec brand.

Capitec Bank was left with only two divisions namely Capitec (banking services) and Capitec CBS (Coetzee, 2003).

- **Capitec Division** – Capitec focuses on providing financing through a highly structured environment to a target market falling into the LSM 4 to 7 income-earning profiles (Coetzee, 2003). Capitec sources its clients from group-based agreements, for example employers or trade unions, however it strives to continue to attract walk-in customers through its distribution network (Coetzee, 2003).
- **Capitec CBS Division** – the Capitec CBS division focuses on providing commercial, unsecured loans on the 'load over load' concept to SMMEs (Coetzee, 2003). This is based on a specific business's acquisition profile through its supply chain. A spin-off is addressed through the Capitec retail distribution infrastructure (Coetzee, 2003). This division is a result of the experience of the founders of Capitec in retail trade (Coetzee, 2003).

3.4 MICRO-LENDING FINANCIAL INSTITUTION LANDSCAPE

Micro-lending financial institutions play a vital role in helping to stimulate the economy as they help develop the low income earning segments of the market, such as the poor and the micro-entrepreneurs, bringing them into the conventional economy (Kumalo, 2011). Micro-lending institutions have been identified as a driving force to help reduce poverty and unemployment levels in emerging economies. What makes micro-lending institutions so attractive to the South African banking industry and possibly within the rest of Africa? Capitec started out as a micro-lending institution, focusing on consumer finance as previously mentioned. It focused on four presiding principles in order to maximise itself as an attractive micro-lending bank. These subsequently helped them enter the South African commercial banking sector. The four principles entail the following (Kumalo, 2011):

- **People:** Capitec identified the need for a sustainable economy to be developed through the micro-lending landscape, a need that must be customer focused. It developed products that were built around the needs and wants of the people, creating awareness and in effect boosting financial literacy at the same time

- **Distribution channel:** Through its unique distribution channel Capitec was able to reduce distribution costs by targeting the people who were financially excluded, providing them with easier access to money through retail shops. By partnering with retail giants, Capitec included the people who were previously excluded. Banking and financial services were brought closer to the people.
- **Technology:** This forms a vital component of the micro-lending landscape and also for Capitec within the commercial banking environment. Reducing transaction costs resulted in the ability to offer an affordable, simplistic and personalised banking solution to the people. Capitec took customer service to another level by bringing the bank to remote areas to people who were previously financially excluded. Using an innovative technology platform to satisfy the needs of its customers has been Capitec's greatest success. This success originated in the micro-lending landscape, where the company first identified the need and opportunity.
- **Pricing:** According to the literature, targeting the financially excluded is costly and will come at a price; however the author of this study disagrees. The financially excluded within South Africa, and the rest of Africa, is a massive market. Therefore, due to economies of scale, offering a cheap cost-effective solution to the masses will have rewards for both shareholders and customers. Capitec has achieved this with its unique business model.

The four principles of a sustainable micro-lending landscape are very similar if not identical to that of Capitec's strategic approach to banking. Its approach rests on the four pillars of simplicity, affordability, transparency and personalised face to face service.

3.5 CAPITEC BANK'S BUSINESS MODEL

The Capitec business model maximises the use of technology and innovation in order to minimise administration and at the same time, day-to-day transactions are reduced, along with associated costs (Capitec Bank, 2011). Capitec's technology-driven business model is the right approach to serving the low-income earning population in South Africa (Haladjian, 2006). In short, Capitec's business model is to

borrow long and lend short (Moneyweb, 2011). Due to this technology-driven business model, Capitec offers strong front-end information technology, including paperless and cashless branches. The company can thus transfer this low cost model over to the customers and subsequently offer the lowest bank charges and fee structures in South Africa. Paperless banking makes it easier and simpler to conduct banking as there are no forms to complete; all tasks are carried out electronically. Capitec makes use of ATMs and drop safes, thereby making all the branches cashless, this is just another way of making banking simpler as well as more affordable.

Capitec was also the first bank in South Africa to trade on Sundays throughout the major shopping centres, in line with retailers' trading hours. This was in addition to its longer operating hours in comparison to the other four major banks in South Africa, namely Standard Bank, First National Bank, Nedbank and ABSA (Capitec Bank, 2011). This is another part of its innovative business model.

Through innovations such as transparent communication via SMS alerts that inform clients of their monthly bank charges and fees in order to save on transaction costs, Capitec has experienced substantial, sustainable growth over the past decade (Capitec Bank, 2011). This bodes well for Capitec's future growth prospects in order for the company to grow into a real player through a red ocean strategy. A red ocean strategy is one where there is existing competition and players try to beat the competition, exploit existing demand and follow a low cost or differentiation model. Transparency and innovation ultimately mean nothing unless they are underpinned by real solutions (Capitec Bank, 2011). The bank is therefore constantly trying to reinvent itself through innovation within the local banking industry. One example is to provide services such as Sunday trading in order to put their customers in control of when they conduct their banking (Capitec Bank, 2011). This innovative approach has been successfully used by corporate giants such as Apple and Facebook internationally and Kulula locally. Capitec shares the common factor of doing things differently, thereby being a change agent in its industry (Capitec Bank, 2011).

Capitec's innovative business model was founded and is still heavily based upon micro-lending. Through this it has become a major disruptor in the South African

banking industry (Moneyweb, 2012). Capitec identified and focused on a niche market by offering market leading cost control and strong brand development (Moneyweb, 2012). This niche was established by identifying a gap in the banking industry, something that the other four major banks did not see. This was a strategic approach that can be described as a blue ocean strategy. In the red ocean strategy, where the major four banks in South Africa compete, the focus is on new mortgages in the traditional middle income markets. They failed to recognise that their existing customer base is more valuable than trying to acquire new clients, which is more costly (Moneyweb, 2012).

Capitec Bank has enticed customers to switch from the other major banks by communicating a clear value proposition to the market (Moneyweb, 2012). According to the chief executive officer of Capitec, Riaan Stassen, there has been nothing magical about Capitec's success. It just identified the correct technology-driven business model, which is working, so it can focus more on its customers (Credit Press, 2012). The other major banks in South Africa are now attempting to enter the lower end of the market, much the same as Capitec has. Standard Bank has added an additional 1.3 million new customers to its existing customer base of 10 million in one year (Credit Press, 2012). ABSA also experienced some growth, with an increase of 1.2 million customers in 2011.

One major difference between Capitec's business model and that of the other banks is that Capitec does not define its customers according to income levels (Credit Press, 2012). All the products on offer by Capitec are available to all of its customers.

3.5.1 Capitec Bank's entry into the emerging market

As mentioned above, Capitec has an innovative technology-driven business model that has been highly successful in South Africa, an emerging market, since its inception in 2001. One of the reasons for its huge success was its ability to recognise and target a niche market comprising employed people with jobs but who are unbanked. This has been a big success factor and part of its unique business model (Ventures, 2012).

South Africa forms part of the renowned BRICS countries, namely Brazil, Russia, India, China and South Africa. The bottom of the economic pyramid presents a significant growth opportunity for banks like Capitec in emerging markets (Deloitte, 2010). Over 13 million people in South Africa are unbanked (Deloitte, 2010). Essentially, two out of five South African adults have no access to any type of formal financial services (Deloitte, 2010). This unbanked market which Capitec targeted equates to approximately R54 billion every year (Deloitte, 2010). It is very difficult for people to participate in the formal economy without having some form of access to a formal banking system (Deloitte, 2010).

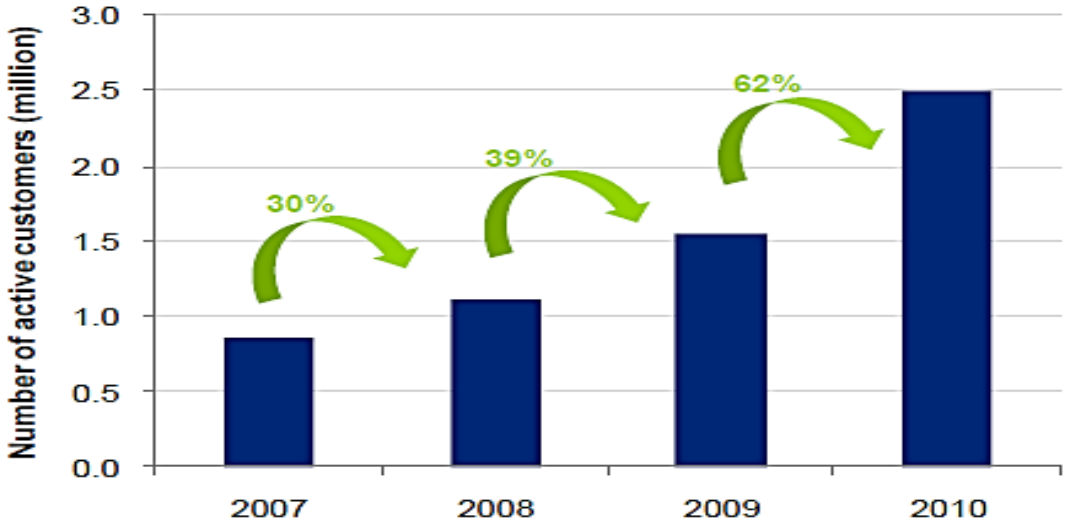
South Africa has one of the largest disparities between rich and poor in the world. The lack of access to financial services and banking poses significant social challenges as well as a threat to macro-economic sustainability (Deloitte, 2010).

There are several reasons why the Capitec business model has been so successful in South Africa (Deloitte, 2010):

- The majority of Capitec customers do not have their own transport. They rely on the taxi/minibus industry which is responsible for commuting an estimated 21 million potential banking customers. This industry turns out approximately R45 billion per year and most of this is unbanked money.
- The cell phone prepaid airtime market is worth R49 billion in revenue per year and the majority of these transactions are cash.

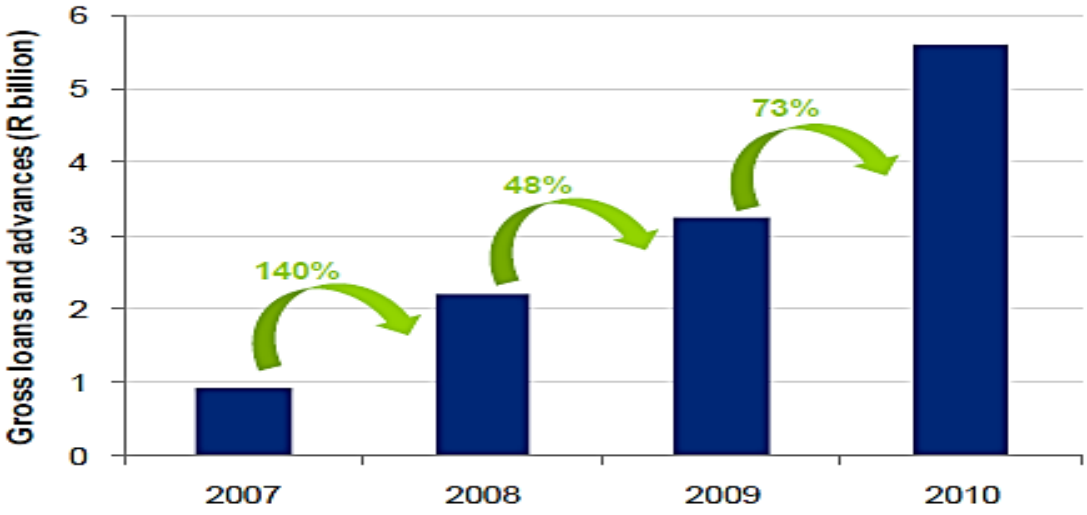
- Exposure of the South African credit market to individuals earning between R1825 and R6150 gross income per month is estimated at R213 billion. This was as at the end of 2009.
- The value of cash-to-cash transfers within South African borders is R19 billion per year. These cash-to-cash transfers represent money that is sent from one individual to another and the majority of this market is uncaptured by the formal sector.

Figure 3.3: Capitec Bank's growth in active customers



Source: Deloitte, 2010

Figure 3.4: Capitec Bank's growth in loans and advances



Source: Deloitte, 2010

Figures 3.3 and 3.4 above depict how successful Capitec's business model has been within an emerging market. Capitec has had phenomenal growth over the past several years.

3.6 CONCLUSION

Chapter three was a literature review on Capitec Bank and how it emerged as a major player in the banking industry of South Africa. Capitec's background was discussed with much emphasis being placed on how it originated from the micro-lending financial landscape. Much of Capitec's success can be attributed to its roots as a micro-lending financial institution where customer service was vital. Major Banks had lost contact with their customers in an effort to grow their capital base and expand their product range. Capitec has however kept to its roots and built a business model around its customers. Its business model was instrumental in its rise to success. It will continue to play a crucial role in cementing the bank as a player within the highly regulated banking environment as well as helping it expand across borders into other emerging economies with a similar business terrain.

Chapter four to follow will be a strategic analysis of Capitec Bank. The author has identified various strategies that Capitec implemented in its rise to success. These strategies will be critically evaluated, conclusions will be drawn and deductions made about the sustainability of Capitec's competitive advantage and how the bank can leverage itself through its core competencies.

CHAPTER FOUR: THE STRATEGIC ANALYSIS OF CAPITEC BANK LIMITED

4.1 INTRODUCTION

This chapter the will highlight the strategic stance and actions followed by Capitec that were instrumental in its rise to success within the banking industry. Further attention will be paid to the blue ocean strategy pursued by Capitec, defining what this type of strategy is and how Capitec implemented it within an oligopolistic industry with high barriers to entry.

An analysis of Capitec's value chain system and core competencies will be presented, how this was translated into a competitive advantage, and whether this can be sustained. The author's own adaptation of the Capitec business model will be developed in order to evaluate this innovative bank. It will conclude with a three litmus test to determine just how effective and divergent the bank's strategy is and will be whilst it tries to expand.

The Capitec Global One product will be examined in terms of its innovation life cycle and S-curve, and how effective the product can be in the future with possible expansion opportunities across local borders within Africa. It will also present an in-depth analysis of Capitec's product and process technology strategy, which was conducted making use of the author's own adaptation of a technology balance sheet.

The chapter will conclude with a feasibility study on Capitec's expansion into the African continent. A case study on Equity Bank in Kenya will be critically evaluated to draw up a possible strategy for Capitec to expand into Africa. Conclusions will be drawn on the level of bank rivalry and competitiveness within the African banking context and a case study approach will be used to practically illustrate the banks' strategies.

4.2 CAPITEC BANK'S STRATEGIC APPROACH TO BANKING

When Capitec rose onto the scene in 2001, its approach to competing in the South African banking industry was what is referred to as a blue ocean strategy or disruptive innovation whereby the company transformed a market that existed, but none of its competitors capitalised on the opportunity i.e. an uncontested market space where the competition is irrelevant (Chan Kim and Mauborgne, 2004). The blue ocean strategy is further defined in table 4.1 below. Capitec used this strategy to capture an untapped market by strategically focusing on the low income earning segment and the unbanked population of South Africa. Furthermore, the company made its competitors irrelevant and created an uncontested market space at the same time. This unique, innovative business model was built around the blue ocean strategy and has been very successful so far.

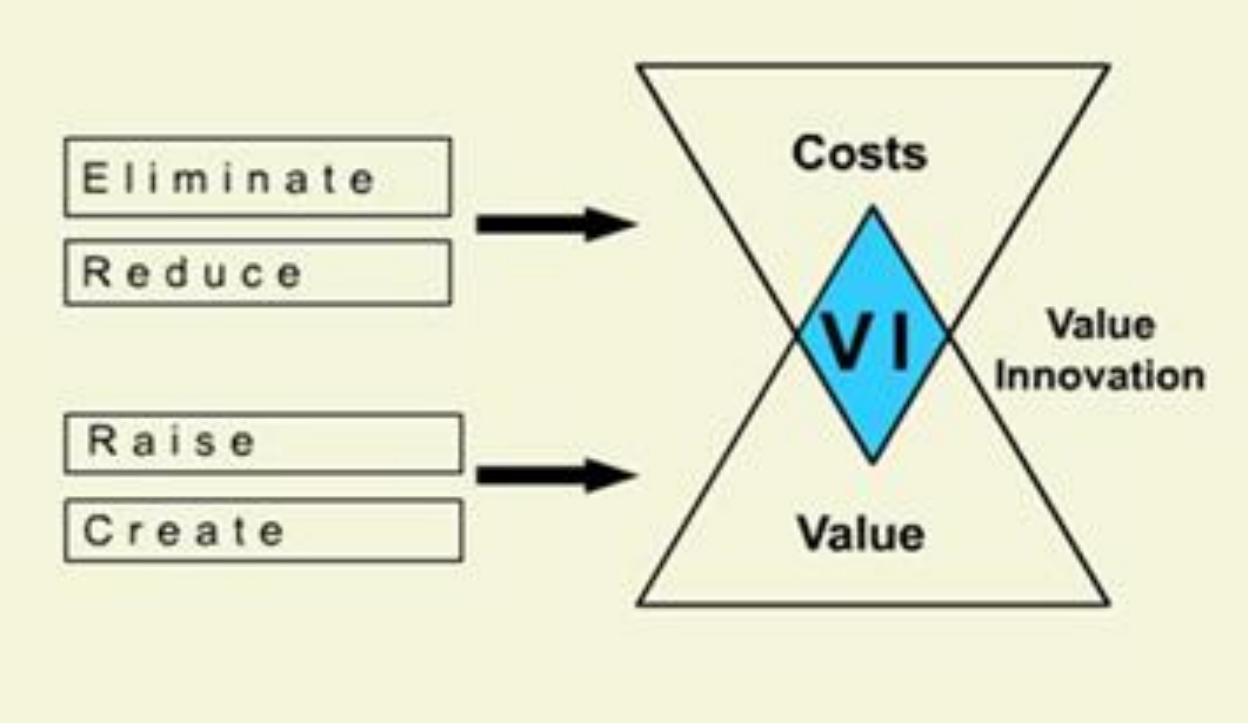
Table 4.1: Difference between a Red Ocean and Blue Ocean Strategy

Red Ocean Strategy	Blue Ocean Strategy
Compete in existing market space	Create uncontested market space
Beat the competition	Make the competition irrelevant
Exploit existing demand	Create and capture new demand
Make the value-cost trade-off	Break the value-cost trade-off
Align the whole system of a firm's activities with its strategic choice of differential ***or*** low cost	Align the whole system of a firm's activities in pursuit of differentiation ***and*** low cost

Source: Chan Kim and Mauborgne, 2004

Figure 4.1 below shows that a blue ocean is created in a region where a company's actions favourably affect both its costs and value creation to buyers (Chan Kim and Mauborgne, 2004). These cost savings come from reducing and eliminating factors on which the industry competes. The buyer's value is raised by creating certain offerings that the industry has never had before (Chan Kim and Mauborgne, 2004).

Figure 4.1: Value Innovation



Source: Jonker, 2012

Using this strategic approach, Capitec captured or invented new demand by offering customers a leap in value whilst simultaneously streamlining costs (Chan Kim and Mauborgne, 2004). The result of pursuing such a strategy was handsome profits, speedy growth and brand equity that lasted for years while competitors scrambled to catch up.

In conjunction with the blue ocean strategy, Capitec pursued a best cost provider strategy which focused on combining a low cost simplistic approach with that of a strategic emphasis on differentiation. Capitec effectively used this type of strategy to its advantage, by offering a low cost simplistic banking solution designed to meet the needs of its target market. This low cost product is the known as the Global One. Not only is it the most affordable banking product in South Africa but it is also designed to add more value to Capitec's customers by being an all-in-one product, offering saving, transacting and investing.

The combination of the blue ocean and best cost provider strategies was the perfect strategic approach to targeting the unbanked, where there was no competition from

any of the competitors. Capitec aligned its entire system in terms of its processes and activities in pursuit of differentiation and low cost (Chan Kim and Mauborgne, 2004).

By adopting this specific strategic approach, Capitec was able to attract large volumes of customers and to generate economies of scale, rapidly putting would-be imitators at an immediate and continuing cost disadvantage (Chan Kim and Mauborgne, 2004). Furthermore, the company was able to set strategic targets directed at its value conscious target market. Due to its understanding of the needs and wants of this market, it was able to develop the Global One concept that appealed to these attributes, providing value for money for the customer. This ultimately is a sustainable competitive advantage and is rather a scarce competence within the banking industry of South Africa.

Capitec's strategy was not to beat the competition but rather to reconstruct the banking industry boundaries by targeting the lower income earning market in South Africa, in other words people that are employed but are unbanked. This was something that the other banks did not focus on.

4.3 VALUE CHAIN, CORE COMPETENCIES AND COMPETITVE ADVANTAGE

"Capitec's competitive advantage lies in its agility, efficient business processes and simplistic outlook on banking service provision" (Deloitte, 2010).

Its key competitive advantage was the implementation of a transparent and cheap pricing package and CEO, Riaan Stassen, indicated that pricing would continue to be pivotal in attracting and retaining customers (Kamhunga, 2011).

As an innovation focused emerging business, Capitec's characteristics can be defined as follows:

- Anticipate future customer needs
- Explore what you don't know

- Hypothesise and learn
- Reward experimentation
- Allow freedom and flexibility

As a result of the above-mentioned characteristics, Capitec stands out from the other major banks by targeting and extending payments and banking services to the lower-middle income markets in South Africa (Deloitte, 2010). During the global economic crisis in 2008/2009, Capitec's competitors focused on defending their revenues, tightening spending and driving credit collections, whereas its competitive approach was to have a more efficient business process and simplistic outlook on banking service provision and to focus on the lower income market (Deloitte, 2010).

As mentioned previously, Capitec uses an innovative competitive approach. By using this innovative technology business model and staying away from expensive products such as vehicle finance and mortgages, the company was able to contain its cost base (Moneyweb, 2012).

Capitec's cost to income ratio is well below the four big banks (Moneyweb, 2012).

Figure 4.2 below identifies and examines Capitec's value chain system, which is crucial to identifying core competencies and translating them into a sustainable competitive advantage.

Figure 4.2: Capitec Bank's Value Chain System

Source: Author's own construction

In order to determine the competitive advantage of Capitec Bank, the value chain analysis is an appropriate tool to determine where the value lies in the business. It allows Capitec an opportunity to see which part of its operations add value and at what cost. In Figure 4.2, areas 1, 2, 5 and 7 are the areas where Capitec currently has a competitive advantage. Areas 4, 6 and 8 need further development in order to sustain its competitive advantage and help gain cost and differentiation advantages. Technology is one of Capitec's biggest competitive advantages; its entire business model revolves around technology in order to provide banking in a simplified yet sophisticated manner.

A risk within the Capitec value chain is product Research & Development. The company needs to develop this aspect further in order to compete among the big four banks in South Africa, should it wish to broaden its product range and compete in the red ocean. These banks offer a wider product range and in order for Capitec to expand into another market segment, it will need to improve the product R&D aspect of the value chain. In order to strategically evaluate the bank, the following questions can be asked to analyse the value chain system:

- **How has technology been monitored? Does the R&D department inform senior management on developments within the industry?**

  Innovation and technology have infused throughout Capitec in a top down manner. This is what drives the business in terms of its business model. Only the best developers and Information Technology engineers are hired in order to develop innovative programs and applications to further cement Capitec as the technology-leading bank in South Africa.

- **What reward systems are used?**

  Capitec gives its employees share options and share appreciation rights to reward them for exceptional work, including technology related activities for technical professionals. This can be described as an intrinsic form of motivation congruent to the temperaments of the staff.

- **Is Capitec ready to deal with non-traditional competitors?**

  Capitec is ready to deal with non-traditional competitors as the company is already a non-traditional competitor. It is constantly looking for new, innovative ways to stay ahead of its traditional competitors.

- **Has Capitec built up a generic variety in its people?**

  Capitec staff is specifically recruited from the local communities where the branches are located in order for them to interact and understand the customers on a more personal level. This helps the staff understand the culture of the customers, which in turn helps Capitec improve its face-to-face service. All newly employed staff members undergo intensive training at the corporate headquarters situated in Stellenbosch in the Western Cape. It is here where the organisational culture is instilled in the staff. This is a major competitive advantage in the banking industry.

Capitec Banks' core management team has been with the bank since its inception and this translates into clear leadership and direction in terms of strategy from a group of astute individuals (Moneyweb, 2012). It can be seen that Capitec makes use of a combination of all three types of leadership styles, namely democratic, authoritarian and laissez-faire. The CEO, Riaan Stassen knows all too well that effective leadership is crucial in order to be a major player in South Africa's financial sector.

Table 4.2 below identifies the core competencies and competitive advantages associated with Capitec's Global One product. It also shows whether its core competencies and competitive advantages are unique and sustainable.

Table 4.2: Core competencies

Technology	Product: Global One
Paperless electronic transacting	**Core Competence: Product - unique service offering.** Very significant and sustainable but competitors will imitate going forward.
Entire technology system was designed specifically for Capitec. Most banks inherit their systems.	**Core Competence: Operations, quality & service - unique service and product offering.** This is a unique competitive advantage that is sustainable.
Internet banking – most secure technology platform of all banks in South Africa	**Core Competence: Operations, quality & service - unique service and product offering.** It is sustainable but competitors can also imitate this and improve it. Recommendation is to manage the technical professionals within Capitec in order to capitalise on innovation for the future.
Mobile banking	**Core Competence: Sales & marketing - unique positioning and market expansion and distribution.** There are tremendous growth opportunities within this type of technology in the banking industry. It will be difficult to sustain, therefore R&D and managing the technical professionals will be key to compete against competitor rivalry.
SMS notification	**Core Competence: Product offering**. It is however not unique within the banking industry.
Process of opening a bank account is all integrated on the MIS and IT system, reducing the administration process.	**Core Competence: Operations, quality & service - unique service offering whereby Capitec has a competitive advantage**. Capitec can go further and sustain this competitive advantage by implementing a complete paperless process and introducing micro-chipped identity card transactions.

ATM's tailor-made for the target market is user-friendly and aimed at the large semi-literate customers in the low income earning profile.	**Core Competence: Sales & Marketing, Product - unique positioning and product offering.** This is a sustainable competitive advantage as the use of technology has catered for a need in the target market. A recommendation is to develop strategic alliances with retail chains in order to offer ease of access to funds. This could be achieved by drawing cash at till points in Pick 'n Pay, Shoprite etc.

Source: Author's own construction

4.3.1 Sustainability of Capitec's competitive advantage

Capitec's competitors are closing in and the bank's average growth slowed from 70 000 customers to 50 000 in 2011, showing clear signs of weaker demand (Mittner, 2011). Patrice Rassou, a Sanlam Investment Management banking analyst, says that Capitec is currently in a 'sweet spot', the microlending market is however becoming saturated with new players (Mittner, 2011). The big four banks are offering products that are similar to those of the smaller banks, but Capitec and African Bank have also subsequently changed their product lines to emulate the big four in order to compete with them, albeit on a limited scale (Mittner, 2012).

CEO, Riaan Stassen has predicted that future customer growth will come from people changing from their existing banks and coming over to Capitec, as well new entrants to banking (Kamhunga, 2012). In order for Capitec to sustain its competitive advantage, it will need to continue to focus on the lower to middle income profile in South Africa. This has been its strategy from the beginning and it has proved to be very successful, averaging 70 000 new customers every month with a projected increase of 55 new branches every year over the next five years (Pitman, 2011). Capitec must therefore continue to focus its strategy on the low income earning market in order to attract more unbanked customers.

Capitec could look into collaborating with leading telecommunication giants such as MTN, Cell C and Vodacom in order to provide additional simplistic service offerings to its customers, that will help make banking easier and more accessible. Mobile

banking is growing in South Africa and the majority of South Africans can now afford cellphones.

Senior management at Capitec will need to devise a new strategy in order for the bank to compete with the red ocean strategies of the big four banks. This strategy would be aimed at the middle to upper income earning profile, as well, as professional customers, and at the same time it would increase the number of loans that could be granted. This, together with the development of a broader product range in comparison to the other four major banks, is crucial in order for Capitec to compete with the major banks. Capitec can do this by means of new channels that encourage continuous innovation both for products and services.

4.4 ANALYSIS OF CAPITEC BANK'S BUSINESS MODEL

Capitec's business model is based on its critical elements and business philosophy, as summarised in Table 4.3 below.

Table 4.3: Capitec Bank's Innovative Business Model

<table>
<tr>
<td>Key Partners
• Strategic alliances with retail stores such as Shoprite and Pick 'n Pay</td>
<td>Key Activities
• Simplified, technology driven solutions to retail banking that is cost effective
• Global One transaction account

Key Resources
• Physical infrastructure and technology platform and related intellectual property
• Human capital</td>
<td rowspan="2">Value Proposition
• <u>Accessibility</u>: strategic positioning of Capitec branches in areas that are accessible near train stations and taxi ranks. Extended trading hours to cater for the target customer needs.
• <u>Affordability</u>: Capitec offers the cheapest ATM fee in South Africa. A minimum of R10 is required to open a savings account, and this R10 can be withdrawn soon after the account is opened.
• <u>Simplicity</u>: Capitec offers a limited product range and use a simplistic transaction methodology, requiring limited paper flow. Its operations are completely paperless and conducted through its IT system.
• <u>Face-to-Face Service</u>: Personalised one-on-one service with timeous feedback. Customers have access to a qualified consultant who can speak the native language of the customer (source of competitive advantage).</td>
<td>Customer Relationships
• Personal and dedicated personal assistance
• Self-service (ATM, internet)
• Customer funding model for retail shops (microenterprises)

Distribution Channels
• Make use of direct and indirect low cost distribution channels
• Capitec branches strategically positioned throughout South Africa
• Mobile branches to reach the target customers
• ATM machines, POS, Internet, CAD and cellphone banking
• Strategic alliances with retail stores such as Shoprite and Pick 'n Pay</td>
<td rowspan="2">Customer Segments
• 'Unbanked customer market in South Africa i.e. people who have jobs and are earning an income, but are unbanked
• Low income earning profile
• LSM 4 - 7</td>
</tr>
<tr>
<td colspan="2">Cost Structure
• Capitec makes use of a cost-driven cost structure
• Minimise costs where possible, creating and maintaining the leanest possible cost structure</td>
<td colspan="2">Revenue Streams
• Fixed menu pricing i.e. fixed prices for a product, service
• Customers are charged the same fixed price regardless of their earning potential, no differentiation between customers
• Inventory credit options and microfinance</td>
</tr>
</table>

Source: Author's own construction

Each one of the critical elements discussed above is instrumental to the success of the bank.

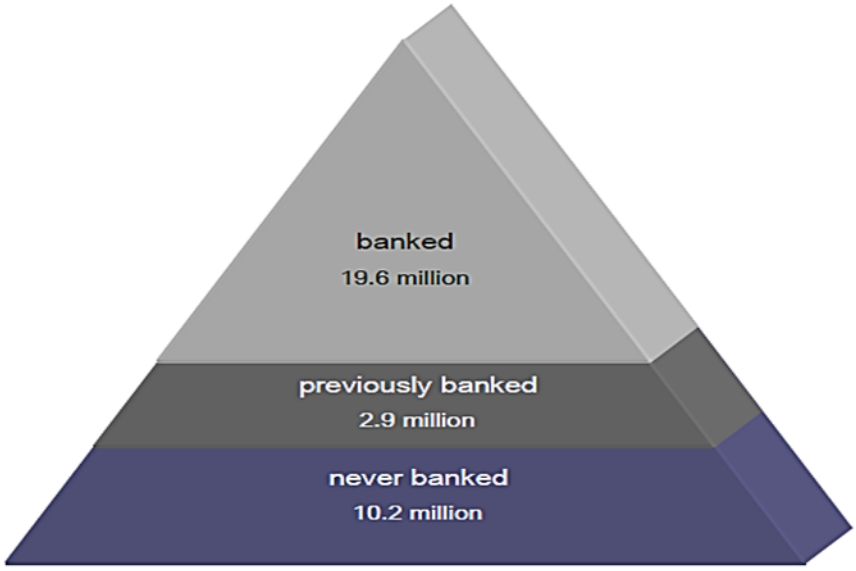
To determine its strategic approach from the business model in Table 4.3, as well as the effectiveness of Capitec's disruption innovation, a three litmus test was conducted, by analysing each of the abovementioned critical elements of Capitec's business model.

A three litmus test is used in order to determine how effective an organisation's strategy will be, and whether it is a disruptive innovation strategy or a new product development strategy. It looks at the new market and determines whether the low end of the market will be interested. This is a vital component for Capitec as its business model is created around the low income earning profile, as was shown above. The last test focuses on how significant players within the industry will be affected, if at all, by the new entrants' disruptive innovation.

- **Is there a large population of people who historically have not had the money, equipment or skills to open a bank account, and as a result have gone without altogether?**

  Capitec's customer segment is the unbanked population of South Africa. Its target market is people that have jobs and earn an income, but are unbanked. The bank focuses on LSM 4 to 7. The unbanked population in South Africa in 2010 was 10.2 million as per Figure 4.3 below:

Figure 4.3: Schematic representation of the unbanked market in South Africa



Source: Deloitte, 2010

- **To use the product or service, do customers need to go to an inconvenient centralised location?**

  Analysing the customer relationships and distribution channels of the business model, the majority of Capitec customers do not have their own transport. They rely on the taxi/minibus industry which is responsible for commuting an estimated 21 million potential banking customers (Deloitte, 2010).

  The location of branches and their smaller sizes are a major source of competitive advantage. Branches are located according to the targeted customers' mode of transport. Within the lower-middle income profile segment, the target customers use the public transport system. The middle income profile segment such as government workers and private sector workers who commute using their own private transport, are also catered for. A prime example of Capitec's accessibility in Port Elizabeth is the presence of four branches on Govan Mbeki road, each targeted at a specific group. The North End and Pier 14 branches are used by customers who are using taxis as their main mode of transport. The lower Govan Mbeki branch is utilised by customers who are using public transport and who are receiving monthly wages. Other branches are

located around retail outlets, for example the Greenacres branch, which caters for various groups of customers.

Due to the fact that the majority of Capitec's customers do not have their own transport, Capitec took the initiative to approach these customers at their place of work or residence in order to encourage them to open new bank accounts on the spot, even granting loans to new customers who previously never had bank accounts.

Capitec therefore provided banking services to its customers at their own convenience, whether it was at their workplace or residence. They also made it easier for the target market to have access to the various strategically located branches

Capitec places emphasis on personal and dedicated service and assistance, making use of both direct and indirect low cost distribution channels by means of mobile banking. The company has developed strategic alliances with certain key partners, including Shoprite and Pick 'n Pay. The significance of these strategic alliances is that the partners understand the needs and wants of their target market. ATM infrastructure within the low income earning profile still needs a lot of development, Capitec circumvented this potential problem by aligning itself with retail giants, giving its customers access to money from retail tills. This is just another way of making banking simplified and innovative.

- **Are there customers at the low end of the market who would be happy to purchase a product with less, but good enough performance if they could get it at a lower price?**

  One of Capitec's key activities, as mentioned before, was to target the low income earning profile with an affordable product, the Global One. The Global One caters for the needs of the low income earning segment in South Africa. There is a huge demand and need for a cheaper alternative to the big four banks. Capitec's Global One outperforms some of its bigger competitors in terms of a higher interest rate and more flexible options to suit the customer's needs, and it does not segment their customers according to income earned.

- **Can we create a business model that enables us to earn attractive profits at the discount prices required to win the business of these over-served customers at the low end?**

  Capitec's unique, innovative technology-driven business model has done exactly that. The bank's key resources, such as its physical infrastructure and in-house technology platform, focused on simplicity and affordability for its customers and running a lean network of branches across the country. This allowed the company to make significant strides in the South African banking industry and profit from it at the same time, even though its product, the Global One, was cheaper than that of its competitors.

Capitec has passed the new market and low end tests; however there is still a third critical consideration.

- **Is the innovation disruptive to all of the significant incumbent firms in the industry? If it appears to be sustainable to one or more significant players in the industry, then the odds will be stacked in that firm's favour, and the entrant is unlikely to win.**

  Capitec's disruptive innovation was very significant to all the players within the industry. Capitec has attained a substantial market share over the decade since its inception. Its competitors have recognised the sustainable threat of Capitec and they themselves have launched new products to compete in the unbanked lower income earning market where Capitec is placed.

Banking is regarded as a complex industry, and various surveys show that many customers complain that they are unsure of what they get in terms of service, as well as the associated costs (Capitec Bank, 2011). This confusion is a result of the multitude of terms and conditions that are attached to the products offered by the banks (Capitec Bank, 2011).

Capitec has simplified banking down to the core functions of saving, credit and transacting (Capitec Bank, 2011). This simplified banking solution is packaged into a

single facility with a transaction account as the access mechanism, which doubles as an additional everyday savings account (Capitec Bank, 2011). This facility is known as the Global One.

Entering into the banking industry as a small time player, Capitec's success was driven by its 'go big or go home' approach (Pitman, 2011). The chief executive officer, Riaan Stassen, pointed out that "You can't compete in the banking industry as a small time player. Not if you want to get ahead" (Pitman, 2011). By comparing Capitec to a motor mechanic and the other established banks to heart surgeons, Stassen said that Capitec had the advantage of being a start-up operation with first mover advantages, while the other banks had to re-invent themselves while serving their existing customers (Cameron, 2011). Capitec aims to become a big bank, not with assets like its competitors, but rather through transactions with its customers (Mittner, 2011).

Capitec identified a gap in the market and built its business around filling that gap (Pitman, 2011). Capitec's advantage lay in the fact that it not only identified market gaps, but also was able to fill those gaps (Pitman, 2011). Capitec's innovative strategy and business model is aimed at addressing customer needs better than its established competitors within the industry. In order to illustrate this point, Capitec is the only bank in South Africa that implemented biometric scanners in the branches (Deloitte, 2010). Due to this innovative approach and the paperless processes within the branches, as mentioned before, Capitec is able to run its branches at a significantly lower cost base whilst its administration processes are much faster than its competitors (Deloitte, 2010). Capitec has placed reliance on its key resources in order to develop a competitive advantage over its competitors. The bigger banks in South Africa offer several different products, whereas Capitec has a limited set, thus allowing it to focus its marketing spend and customer service in the lower income markets (Deloitte, 2010). Through this strategy, Capitec can pass on the benefits to its customers.

Stassen pointed out that the bank focuses on what the customers want. He believes in face-to-face relationships with customers and one of the bank's main objectives is to go where the customers are (Pitman, 2011). Capitec does this by offering

simplified banking that cuts across all income segments as it believes that banking needs are the same regardless of income earned. In other words markets should not be segmented according to income (Kamhunga, 2012). Capitec's cost structure and revenue streams give it the ability to offer one set of costs or fee structure for all its customers, there are no options (Cameron, 2011). It tries to minimise costs where possible by making use of a cost-driven cost structure. It also offers extended banking hours beyond 08:00 and 17:00, just one of many value add benefits infused into its business model (Anon, 2009).

Capitec's strategic focus and value proposition is accessibility, affordability, simplicity, convenience and face-to-face service.

- **Accessibility** – Capitec branches are positioned in areas that are accessible, near train stations or taxi ranks. As mentioned above, the bank offers extended trading hours in order to cater to the customers' needs and to fit their work schedules. In certain circumstances, branches stay open even longer. Accessibility is the most important factor, especially since Capitec's customer base, being the lower income earning profile, has a heavy reliance on public transport. At one branch, specific arrangements were made with a group of factory workers for services at a specified time at the end of the month. This not only focuses on Capitec's accessibility, but more importantly it shows the company's loyalty and appreciation of its customers and their businesses (Coetzee, 2003).
- **Affordability** – Capitec offers the cheapest ATM fee. In order to open a savings account, a minimum opening balance of R10 is required. The R10 is only an opening fee and can be withdrawn soon after the account is opened. There is no permanent minimum balance on the savings account. Affordability is an important factor in convincing customers to join Capitec. Access to money and good customer service are also important priorities (Coetzee, 2003).

  Crime in South Africa is a major problem and this affects the cost of financial services. Capitec has put recovery plans in place by implementing a card-

based system, keeping cash on hand to a minimum at branches. In this way, Capitec brings down the costs associated with robbery and crime (Coetzee, 2003).

- **Simplicity** – Capitec has a limited product range and uses a simplistic transaction methodology, requiring limited paper flow for its product range. The operations have been developed so that they are completely paperless, i.e. customers are not required to fill in forms or slips to transact. All transactions are card based and transactions that are not done on the computer are scanned onto the IT system. The simplicity of the system and processes results in faster service, giving staff more time to interact with customers. Many of Capitec's customers are illiterate, therefore Capitec made use of technology in order to adjust its ATM screens to suit the needs and preferences of Capitec's target customers (Coetzee, 2003).
- **Face-to-Face Service** – Personal one-on-one service and timeous feedback and response time are part of Capitec's strategic approach. When Capitec was formed, many of the microfinance institutions acquired by Capitec were managed by their owners. This meant that customers were used to personalised service. For this reason, Capitec places a high premium on face-to-face service, with easy access for every customer to a qualified consultant who can speak the native language of the customer (Coetzee, 2003). This personalised form of service is becoming extremely rare in the formal banking sector in South Africa, and is a source of competitive advantage for the bank.

A major part of Capitec's success is the fact that it looks at the interests of its customers first, and profits for its shareholders second (Cameron, 2011). As a testament to the fact that the customer comes first at Capitec, the company embarked on a project called Speak Up in an attempt to identify customer wants and needs (Anon, 2012). Charl Nel, Head of Strategic Communications at Capitec, said that "A smart brand listens, reinterprets what it hears and presents its customers with a solution that meets their needs. This is the basis of Speak Up" (Anon, 2012).

This project revealed that customers wanted the following, among others:

- To be treated like their business is needed
- Face-to-face personalised service
- Slashing of excessively high banking fees
- High degree of technology
- Kid-friendly banking
- More simplified, smoother banking – no long queues
- Service and advice in their native language

Capitec has made it a priority to have a zero gap between what customers expect and what customers receive (Cameron, 2011).

Going forward and looking ahead, Capitec will be increasing its growth prospects with its proposed branch expansions over the next few years and will increase its customer base in order to secure more of the unbanked population. Capitec has already established twenty eight new branches throughout South Africa over the last six months.

4.5 CAPITEC'S PRODUCT AND PROCESS TECHNOLOGY STRATEGY

4.5.1 Introduction

Capitec's product and process technology strategy analyses its use of key resources such as its innovative technology platform. The purpose of this section is to critically evaluate this particular element of the business model in more depth. Conclusions will be drawn as to how Capitec maximises technology within its strategy, positioning it as a technology leader. Due to the fact that Capitec places much reliance on technology within its business model, the author has dedicated an entire section towards this technology strategy, detailing how the Global One product is strategically placed as one of the critical elements of the business model.

4.5.2 Key Resource: Technology Strategy of Capitec Bank

In order to determine the effectiveness of its innovation capabilities, the following questions have been formulated to detail the technology strategy pursued by Capitec:

- **How does management recognise technological issues as input to long term or short term planning?**

  Technology is at the forefront of Capitec's corporate strategy. Technology is a top-down process and its importance is recognised by the CEO, Riaan Stassen. Capitec's technology platform had to be designed to handle high volume, low value transactions quickly and efficiently and at the same time be scalable (Pitman, 2011). The system was innovative in the sense that it was engineered to be process-driven with a high degree of centralised control (Pitman, 2011). The reason for this was that Stassen wanted to remove most of the administrative burden at the customer interaction level (Pitman, 2011).

  Stassen also pointed out that setting clear objectives on what the bank wanted to achieve was vitally important in selecting the appropriate technology platform (Pitman, 2011). The system has allowed Capitec to sign up customers within ten minutes by way of its paperless processes. New customers only need their identity documents and proof of residence, and due to mobile banking, some customers do not even need to visit a branch to open an account (Pitman, 2011).

- **How has technology been utilised to implement strategic objectives?**

  Technology is a long-term component of Capitec's value chain and has been instrumental in achieving its strategic objectives and the development of its innovative technology-driven business model. Figure 3.7 below illustrates Capitec's value chain.

4.5.3 Innovation life cycle and S-Curve for Capitec's Global One

Table 4.4 below illustrates where the Global One product currently stands in its lifecycle and what relevant challenges it faces.

Table 4.4: Innovation Lifecycle and S-curve – Global One

Product	Early Adopters Business challenges / Leadership / Metrics	**Mass Market** **Business challenges / Leadership / Metrics**	Mature Market Business challenges / Leadership / Metrics	Late Adopters Business challenges / Leadership / Metrics	Decline Business challenges / Leadership / Metrics
Global One		• **Business growth, increased profits, creating and owning their own industry standard.** • **Leadership: ability to live with high uncertainty in planning and forecasting, emphasis on flexibility and efficiency, focus on end objective while remaining flexible and efficient.** • **Metrics: Segment share, time to market to create standard, NOT CAGR.**			

Source: Author's own construction

In comparison to the big four banks in South Africa, Capitec has a limited product range, which allows it to keep marketing and customer service costs down and focus on a more direct approach. This leads to a competitive advantage for Capitec by focusing on the lower-middle income market with a more defined product range.

In order for Capitec to expand, the company will start to leverage its position and business processes to take on the major banks, targeting the middle-upper income market (Deloitte, 2010).

Technology is at the forefront for Capitec Bank and the company makes use of this as its main distribution channel. Another competitive approach is the use of retailers for distribution (Haladjian, 2006). Approximately 5% of Capitec's customer base makes use of cash withdrawal systems from retailers such as Pick 'n Pay and Shoprite, with whom it has a business relationship (Haladjian, 2006). It is also looking at opening banking units on retailers' premises, for example Shoprite, with funds-transfer arrangements to enable customers to send money to other parts of the country in a cost-effective way (Haladjian, 2006).

Part of Capitec's corporate niche market model and one of its most successful competitive approaches is the 'our pillars. Due to the extended trading hours, customers have easy access to banking services (Coetzee, 2003). This is something that the other four major banks do not have. They still follow the traditional branch placement and design, which suits the bank but not the customer. The way business, and more specifically banking, is conducted is an ever-changing paradigm within the context of globalisation. What worked before might not be the best solution or strategy at present or in the future. Capitec realised this and is making the best of the advantages that go with being the first mover, having reversed the process by making banking easier for the clients than for the bank (Coetzee, 2003).

Being in the unsecured lending market, Capitec became very good at assessing the quality of the cash flow to determine whether customers can make their repayments. The big four banks, on the other hand, became good at evaluating security to extend credit to fund houses and motor vehicles (Moneyweb, 2011).

Further, Capitec is cautious about divulging future plans, preferring rather to tell the market what it has done (Moneyweb, 2011). Stassen quoted, “I am not going to give my opposition an early warning for them to react before I’m there” (Moneyweb, 2011).

Table 4.5 below illustrates a suggested technology-based balance sheet that can be implemented as a new strategic approach for the bank. A technology balance sheet is an effective strategic tool that looks at a holistic view of the business operations of an organisation. From a strategic point, it compares all the core competencies against the various technologies and processes in play, and shows how to use technology effectively to improve the organisation’s product offering. It is a tool that can help identify potential new market opportunities and develop strategies for any organisation, especially industries where competitor rivalry is high and innovation is at the forefront of the business model.

The conclusion to be drawn from Table 4.5 below is that Capitec must try to leverage its technology platform in conjunction with its core competencies, sales and marketing, for both market positioning and market expansion. Sales and marketing have been identified in the value chain as an area to improve on and should the bank wish to compete with the major players this must become a priority. Entry into the red ocean will rely on Capitec’s efficient and simple processes, combined with that of simplistic technology platforms aimed at not only the lower income market but the middle to upper income market as well.

Table 4.5: Technology Balance Sheet – Capitec Bank

Technologies					Products	
					Global One	
					X	Unbanked Market
Paperless electronic transacting	IT & MIS system	Internet	Mobile banking	Core Competencies		
		X	X	Product: Unique product offering	X	
X	X			Operations, Quality & Service: Unique service offering	X	
X				Sales & Marketing: Unique positioning		
X				Sales & Marketing: Market expansion		
			X	Distribution	X	

Source: Author's own construction

4.6 EXPANSION INTO AFRICA

4.6.1 Introduction

Due to the unstable business terrain and high unemployment levels on the African continent, together with contributing factors such as an unstable political environment, expansion by South African banks into Africa could be a challenge. With that said, expanding across borders has the potential to be a very lucrative opportunity, if executed correctly. Unemployment in Africa is caused by seasonal layoffs, changes in technology, racial discrimination a lack of necessary skills and fluctuations in the economy (Frimpong, 2012).

Unemployment across the African continent is a very serious problem. In accordance with the International Monetary Fund (IMF) and the World Bank, many African countries applying structural adjustment measures have retrenched large numbers of public sector employees.

One of the main causes of unemployment in Africa is the defective education system. Throughout Africa the focus in the education system is on theory instead of practical. The education system should focus on training people with specific skills that will enhance productivity in the workplace. Africa's educational policies produce individuals whose skills do not reflect the economic trends within the job market. Self-employment is crucial for the growth of an economy and most of the African population lives in rural areas where self-employment plays a major part. Unlike the developed nations, Africa's well qualified people do not possess the means for self-employment; they therefore look for jobs where they can receive a fixed wage or salary (Frimpong, 2012).

Another major concern within the African business environment is the lack of political stability, the negligence of leaders and corruption, which consumes Africa making it an unstable business terrain. The unstable business and political environment encourages a culture of power retention as well as money embezzlement. The necessary capital needed in order to develop this sector is used for personal gain and wealth and unfortunately this promotes further deterioration, resulting in Africa remaining underdeveloped (Frimpong, 2012).

Although most of Africa is not suited to Capitec's business model due to the above-mentioned factors, there are several countries which the author believes are suitable for Capitec's business model, as with South Africa. Countries such as Namibia, Nigeria, Gabon, Mauritius and Botswana all have lower unemployment rates than South Africa, as well as an economy that can support Capitec's business model. The best and most efficient manner in which Capitec can expand into Africa would possibly be to acquire or merge with Equity Bank. The case study below on Equity Bank illustrates the attractiveness of such a venture for Capitec and how it could establish itself in the rest of Africa.

4.6.2 Successful expansion into Africa: The case of Equity Bank Ltd

a.) History and background

Equity Bank was founded in October 1984 and was originally a provider of mortgage financing, targeting customers in the low income earning market segment. Equity Bank's transformation from a micro-lending institution to a commercial bank is a success story to take note of. Today, the bank engages in retail banking, microfinance and other services to individuals and small to medium sized businesses in Kenya, Uganda, Rwanda and South Sudan. By 2012, Equity had a customer base of more than 8 million, making it the largest bank in Africa (Equity Bank, 2013). Today, Equity offers its customers a wide array of different products and services, which include current accounts, fixed deposit accounts, business and development loans, agricultural loans, working capital loans, educational loans and asset finance to name but a few (Reuters, 2013).

b.) Equity Bank's Strategic Approach

Equity Bank's strategic approach to banking is very similar to that of Capitec. It targeted the unbanked customers in Kenya, understanding their needs better than anyone else. Equity created banking products and services that were attractive and accessible to the low income earning segment of the population. Combining attractive and accessible products with innovation and technology aimed at the

unbanked, it was catapulted to feature among the top banks in Kenya (Ratichek, 2011).

As mentioned, Equity targeted the unbanked market. In order to achieve its objectives, it adopted a strategic approach known as the 'agency model'. This strategy used wireless communications technology to provide 'branchless banking' through a network of agents that already existed across the country, instead of creating a new infrastructure of branches and ATM's. This was one of their unique selling points and key success factors. Jobs were created by hiring local people and training them to expand their sales and by conducting money transfers between individual customers or between individuals and businesses. This approach allowed the bank to provide services at a discounted price in comparison to the traditional branch model using ATM's and a mobile bank van (Ratichek, 2011). Innovation and technology were at the forefront of this strategic approach and business model, an approach that can be compared with Capitec.

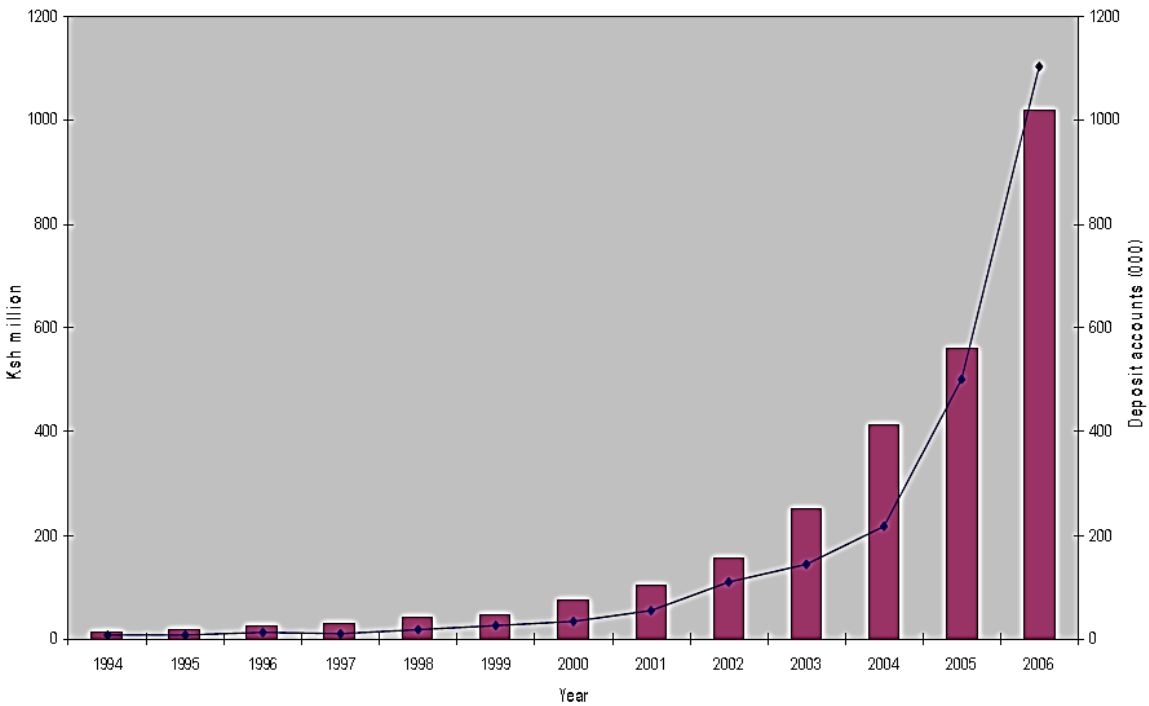
As with Capitec's strategic approach, which is underpinned by four pillars, Equity Bank's strategic approach is supported by three similar pillars, namely (Equity Bank Group, 2012).

- **Pillar 1 – Unique distribution model:** Equity uses innovation and technology to reduce costs and improve customer proximity.
- **Pillar 2 – Customer driven approach:** Equity has a broad customer base focusing on high volumes and low margins. The bank also pursued a disruptive innovation strategy similar to Capitec's.
- **Pillar 3 – Alignment of organisational culture and innovative business model:** Equity possesses a formidable brand within the banking industry in Africa, in addition to its innovation and technology.

The three pillars discussed above are held together through a banking offer to the target market that is accessible, affordable and efficient. Comparing this to Capitec's strategic approach of accessibility, affordability, simplicity and personalised service,

it is not surprising that Equity has been so successful since its inception. Figure 4.4 below clearly depicts just how successful it has been.

Figure 4.4: Customers and profits of Equity Bank since 1994



Source: Wright and Cracknell, 2007

c.) Equity Bank's Business Model

Table 4.6 below illustrates the unique innovative savings-led business model that has seen Equity rise to success and establish itself as the bank of choice in Kenya and other parts of Africa.

Table 4.6: Equity Bank's Innovative Savings Led Business Model

<table>
<tr>
<td rowspan="2">Key Partners
• The United Nations Development Programme (UNDP)
• Kenya Co-operative Creameries
• Helios Investors LP Fund I</td>
<td>Key Activities
• Simplified, technology driven solutions to retail banking that is cost effective
• 'EAZZY 24/7 Mobile Banking'</td>
<td rowspan="2">Value Proposition
• <u>Accessibility</u>: Equity offers branchless banking through its agency model of distribution. It has 186 branches, 3991 agents and 1.55 million mobile banking customers
• <u>Affordability</u>: Low cost deposits due to stable funding by gathering large volumes of relatively small deposits
• <u>Efficiency:</u> Diversified and highly efficient methods of attracting customers focusing on providing easy access to banking services at the lowest cost. Unrivalled mobile banking service (EAZZY 24/7) and the roll-out of agency banking to get closer to the customers in remote areas</td>
<td>Customer Relationships
• Personal and dedicated personal assistance
• Automated self-service (Online, Money transfer & Card services, mobile banking)
• Branchless banking</td>
<td rowspan="2">Customer Segments
• Mass market at the 'bottom of the pyramid'
• Unbanked customers in the low income earning market segment</td>
</tr>
<tr>
<td>Key Resources
• Physical infrastructure and technology platform and related intellectual property
• Human capital
• Financial</td>
<td>Distribution Channels
• Multi-channel unique distribution model
• Agency model using wireless communications technology, cutting out the need for ATMs and branches
• Branchless banking using existing merchants or agents</td>
</tr>
<tr>
<td colspan="2">Cost Structure
• Equity Bank uses a cost-driven cost structure
• Minimise costs where possible, creating and maintaining the leanest possible cost structure</td>
<td colspan="3">Revenue Streams
• Fixed menu pricing i.e. list pricing structure, fixed prices for a product, service etc.</td>
</tr>
</table>

Source: Author's own construction

d.) Comparison between Equity Bank and Capitec Bank

Based upon the case study of Equity Bank, the author believes that Capitec will flourish in certain parts of Africa. Capitec and Equity Bank have very similar business models and strategies. They both developed blue ocean and focused best cost provider strategies. As mentioned previously, the African climate is somewhat volatile, with high unemployment, but there are sure signs of opportunity within the banking industry for Capitec to grow its brand. Equity Bank was established in 1984 and is stronger than ever and this bodes well in terms of sustainability. Other major players are expanding into Africa but none are more suited than Capitec, with its cheap and affordable banking offer that appeals to the masses throughout Africa.

4.7 CONCLUSION

Capitec Bank developed its competitive advantage by concentrating on the lower to middle income earning profile, in other words people that are unbanked. This market segment was critically evaluated in Chapter four. Up until now it has been remarkably successful and has achieved on average 70 000 new customers every month and have anticipated an increase in 55 new branches per year over the next five years (Pitman, 2011). CEO, Riaan Stassen has also predicted that future growth of the customer base will come from people changing banks and from new entrants from the lower to middle-income segments (Kamhunga, 2012).

Capitec's customer base is a reflection of the demographics of the South African population and it has more exposure to this target market than the big four banks (Moody's Investor Service, 2013).

In order to sustain its competitive advantage, Capitec must develop a strategy for winning more middle to upper income earning profiles. Capitec has had success in broadening its product range, specifically its transactional banking services and savings products (Moody's Investor Service, 2013). This has subsequently strengthened its franchise position, providing revenue diversification and supporting growth potential (Moody's Investor Service, 2013). Through this Capitec can capture part of the other banks' large customer base, increasing its own growth.

Capitec is becoming stronger and stronger, as can be seen in the broadening of their funding base. Retail deposits represent 58% of non-equity funding as of August 2012 and this is one of the highest in South Africa. It has also diminished concentrations in its funding base (Moody's Investor Service, 2013). The bank also has a strong loss absorption capacity, as demonstrated in its solid capital cushion and strong and resiliant profitability (Moody's Investor Service, 2013). The bank has very good liquidity management practices which bodes well for a positive outlook going forward (Moody's Investor Service, 2013).

Capitec's outlook looks very positive, with international expansion on the cards in the not too distant future. It has developed a proven track record over the last decade in credit risk management practices, especially during the trying times of the economic recession in late 2008 and 2009.

The following drivers are key to the bank's continued success in the years ahead:

- Targeting a small niche market in the unsecured lending industry (Moody's Investor Service, 2013).
- Potential for systematic support (Moody's Investor Service, 2013).
- Buffer to absorb unexpected credit losses through a solid capital cushion and resilient profitability (Moody's Investor Service, 2013).
- Increasingly diverse funding base, while adopting prudent practices in managing liquidity risks (Moody's Investor Service, 2013).

If Capitec can maintain sound financial fundamentals under even more challenging credit conditions, consolidate its current franchise position and broaden its funding base and revenue source still further, it is likely to change the banking environment in South Africa, even more so than it has already done(Moody's Investor Service, 2013).

On the other hand, Capitec should be wary because of its aggressive business model and balance sheet growth. Its stance could possibly give rise to credit and liquidity issues (Moody's Investor Service, 2013). Asset quality, earning power and

capital position could possibly be affected if the GDP growth rate slows down and there is a higher growth rate in unsecured lending (Moody's Investor Service, 2013).

Chapter four concluded with an analysis of Equity Bank, a bank that has had tremendous success in Africa with a similar low cost innovative business model to Capitec bank,putting technology at the forefront. Equity Bank has been successful due to its ability to adapt its business model to the economic climate and environment in which it finds itself. The analysis of Equity Bank highlighted the potential for Capitec to expand into certain parts of Africa because of its very similar strategic approach to banking. Capitec focuses on the unbanked population and Africa has a massive unbanked population. The critical elements of Equity Bank's business model were analysed and compared favourably to Capitec's model. Some of the other major players in the South African financial sector are expanding into Africa but none of them are more suited than Capitec.

Chapter five to follow, summarises the research treatise, drawing conclusions based on findings and making recommendations.

CHAPTER FIVE: SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 INTRODUCTION

In chapter four, the research is summarised and the main findings are linked back to the main issues addressed. Conclusions and recommendations will be made based on the main findings of the research followed by opportunities for further research. Chapter four concludes with a chapter summary.

5.2 RESEARCH SUMMARY

The research summary will comprise an outline and proposed recommendations arising from the research questions identified in chapter one of the research treatise. A summary of the main findings of chapters two, three and four will also be presented.

5.2.1 Research objective and research questions

The research objective identified in chapter one was:

"A Strategic Analysis of Capitec Bank Limited within the South African Banking Industry".

Six research questions were identified in order to conduct a strategic analysis of Capitec Bank, making conclusions and proposing recommendations for the bank going forward. The six research questions identified were:

1. What does a banking industry analysis reveal about the success of Capitec in the South African banking industry?
2. What is the strategic approach and competitive position of Capitec in the South African Banking Industry and how does the company implement its business strategy?

3. What is the base of Capitec's competitive advantage and competitive strategy?
4. How can the unique business model of Capitec be described?
5. What are Capitec's key success factors (KSF) and how well are these KSFs employed?
6. Can the strategy employed by Capitec in South Africa be duplicated in the rest of Africa?

The six research questions were strategically analysed within the context of the South African economy and the state of affairs of the major players within the financial sector and relevant conclusions and recommendations were drawn.

5.2.2 Synopsis of the literature review

A summary of the main findings pertaining to the research objective was given under the following sub-headings:

a.) Banking industry in South Africa
b.) The Capitec Bank business model and key success factors
c.) Competitive advantage and strategic intent of Capitec Bank
d.) Expansion into the rest of Africa

a.) Banking industry in South Africa

Porter's Five Forces established that although the banking industry in South Africa is oligopolistic by nature, a market will always exist to cater for the unbanked clientele. This is because there will always be a need among lower income earners for a simplified and low cost banking solution. Due to the nature of the industry barriers to entry are very high; therefore the threat of potential new entrants is very low. This was confirmed when analysing the history of the financial sector.

Competitor rivalry is fierce and the only distinguishing factors among the banks are that of cost and fee structure. Subsequently, the four major banks dominating the South African market have attempted to execute a similar

strategy to that of Capitec's in order to capitalise on the unbanked market sector.

The threat of substitutes is a moderate force in Capitec's business strategy. Capitec seized the opportunity by differentiating its strategy to target the unbanked, something that its competitors did not do. Only recently have the four big banks targeted the same lower income market that Capitec targeted from the beginning. A SWOT analysis of the industry allowed Capitec to identify its strengths in order to capitalise on the opportunities in the market and at the same time to determine the financial health of the banking industry. This analysis allowed Capitec to identify the unbanked population and subsequently develop a business model focusing on the low income earning profile.

After conducting an industry analysis of the banking industry in South Africa, it was established that Capitec, stemming from the micro-lending environment, has been very successful by focusing on the mass market. The strategy that Capitec implemented has now caused the traditional mainstream banks to re-look at the unbanked mass market (Kumalo, 2011).

Although Capitec's target market was the unbanked mass market in South Africa, they also target micro-entrepreneurs, which contributed to their industry success and added to their attractiveness (Kumalo, 2011). More specifically, Capitec realised that the micro-entrepreneurs were not being served. In South Africa, micro entrepreneurs make up a substantial share of the fast moving consumer goods (FMCG) industry in terms of small retail shop outlets (Kumalo, 2011). It was through this opportunity that Capitec acquired Key Distributors (Pty) Ltd (KD) in 2004. As shown in Figure 5.1 below, Capitec owns 75% of KD and through this strategic acquisition Capitec was able to cement itself in the micro-lending sector (Kumalo, 2011).

Figure 5.1: Capitec Subsidiary Holdings

Source: Capitec Bank, 2013

Capitec developed a customer-funding model, the basis of which allowed customers to buy more at retail outlets by granting them stock credit (Kumalo, 2011). Capitec's operating model for KD was for it to be a subsidiary and run as an independent business (Kumalo, 2011). Capitec delivered this to the micro-enterprises by providing micro-entrepreneurs with funding for a portion of their inventory for their retail shops, with the business being driven from a supply chain point of view (Kumalo, 2011). Capitec established a link with its unbanked mass market through KD which had five depots distributing goods to the unbanked low income earning market segment. KD therefore acted as an intermediary between the customers and the depot, ensuring that the customers made the required repayments if inventory credits were used (Kumalo, 2011). KD services 2 500 retail shops across three provinces, namely Gauteng, Limpopo and Mpumalanga (Kumalo, 2011).

b.) The Capitec Bank business model and key success factors

In order to draw conclusions from the strategic analysis in chapter four, the strategic relevance of each of the critical elements that make up the Capitec business model was analysed. This is discussed below. Each element of the

business model places reliance from a strategic viewpoint in order to help senior management make the decisions that will allow the bank to grow as a market leader in South Africa and also to cement itself across borders.

Key Partners:

Strategic alliances and partnerships with leading retailers such as Pick 'n Pay, PEP and Shoprite were a critical element of the business model. Capitec knew that in the market, in which it was operating, the low income earning profile, customers have jobs but they rely heavily on the taxi industry for transport to work, and the areas where they live lack the necessary banking infrastructure. In order to circumvent this, the company created alliances with retail giants, which allowed their customers to draw money from till points. This was instrumental in getting money to the customers.

Key Activities:

Capitec developed a simplified, affordable technology-driven banking solution. In an emerging economy like South Africa, the need for a low cost banking model was critical. Capitec developed a 'one size fits all' approach, and using innovative technology implemented its Global One product.

Key Resources:

Key resources were intellectual capital, physical infrastructure and a cutting edge technology platform specifically designed to fit the needs of the bank. As mentioned previously, other banks have adopted Capitec's technology platform. Capitec on the other hand tailor-made its technology platform to suit its business model and strategic approach. This has been a competitive advantage which can be improved even more in order to cement it within the banking industry.

Value Proposition:

The four pillars on which Capitec's strategic approach was based were:

- Accessibility
- Affordability
- Simplicity

- Personalised face-to-face service

This is arguably the most important element of the business model. Without this value proposition, Capitec would not have been so successful in such a short time span. A business can identify a market and can have a customised product within the financial sector but without a good value proposition it will not be able to connect with its target audience. All the other elements of the business model are built around and infused with the value proposition. Customers are concerned with the why and not the how. In order to maximise its market share, Capitec asked why its customers do business and not how.

Customer Relationships:

This element of the business model goes hand in hand with the value proposition. Capitec brought personal and dedicated service back to South African banking. The larger banks in the industry have lost the personal connection with their customers, focusing on fees and revenue. Capitec realised that by placing its customers first and making sure that it understood the needs and wants of its customers, the bank would ultimately grow.

Distribution Channels:

Capitec uses both direct and indirect low cost distribution channels, with branches strategically positioned across South Africa to cater for its target market. Mobile branches, ATM's, internet, cell phone banking and POS all add to the value proposition. The strategic relevance of Capitec's distribution channels is important for the bank to add value and pursue a focused best cost provider strategy. In order to target the unbanked market, Capitec needed a distribution model that would fit its target customer profile within the economic climate of South Africa, as discussed in the PESTLE analysis in chapter two. Its customer funding model is unique in that it allows customers to buy more at retail outlets by granting stock credit, an innovation targeting micro-enterprises within an emerging economy.

Customer Segments:

The unbanked customer segment refers to customers who are employed and earning an income but who do not have a banking account. Capitec targeted the low income earning profile, LSM 4 to 7. The strategic relevance was that this massive market existed but no bank had attempted to target it. The rewards to Capitec for pursuing this blue ocean strategy were first mover advantages such as market share, brand loyalty and handsome profits.

Cost Structure:

Capitec uses a cost-driven cost structure, whereby costs are minimised where possible, creating and maintaining the lowest cost structure. They offer the lowest fee structure, making it affordable to customers but at the same time giving then value through an all-in-one banking offer. The relevance here is that Capitec does not sacrifice the one for the other, low cost and value adds are packaged into one banking offer.

Revenue Streams:

Capitec uses a fixed menu pricing, i.e. customers are charged the same fixed price regardless of their income. The bank does not differentiate between customers; this has allowed it to attract more customers from the middle to upper income earning profile which is important for its long term sustainability.

Various key success factors aligned to its corporate strategy enabled Capitec to reach its business goals. The idea of paperless transacting, and the use of technology, was the perfect strategy to align Capitec with the needs and wants of its customers, of whom the majority were illiterate or semi-illiterate.

The other major banks in South Africa based their technology model on previously established platforms whereas Capitec designed its platform to meet the unique set of needs and wants of its customers. Paperless transacting removed the administrative burden from the customer interaction point.

Capitec was also the first bank in South Africa to extend its trading hours from 08:00 to 17:00 as well as trading on Sundays, another example of disruptive innovation being employed.

Mobile banking and the use of native languages has set Capitec apart from its competitors. Customers want to feel that they are valued and the ability of Capitec employees to effectively communicate in the customers' native language is an important success factor that puts the bank ahead of its rivals. The majority of customers do not have transport; Capitec therefore put measures in place and filled the gap by bringing the bank to the customers.

Lastly, the leadership of a visionary CEO, Riaan Stassen, was a pivotal component of the banks tremendous success over the past decade.

c.) Competitive advantage and strategic intent of Capitec Bank

Capitec is regarded as an innovation focused emerging business and its goals are as follows:

- Anticipate future customer needs
- Explore what you don't know
- Hypothesise and learn
- Reward experimentation
- Allow freedom and flexibility

Capitec has no publicly traded debt or equity; it is therefore favourably positioned with a ROE and a high share price in comparison to the major players within the industry. What led to this favourable position was its strategic approach to banking. The company targeted the unbanked population, a completely new and untapped market segment. Furthermore, it realised the importance of this market by providing the best possible customer service. CEO, Riaan Stassen realised that although different market segments earn different incomes, their basic banking needs do not differ much. The implementation of this approach resulted in a simplified banking system, providing the core functions of savings, credit and transacting at the

most affordable price on the market. In effect Capitec identified and targeted a gap in the market and built the business around this gap, resting on the four pillars, namely accessibility, affordability, simplicity and personalised face-to-face service.

Within the culture of Capitec, customers always come first while shareholders and profits come second. This is testament to the on-going importance of the interests of the customer base. This was the vision behind Capitec's Speak Up project. This project was implemented to identify the wants and needs of the customers. Capitec pursues a zero tolerance gap between what it thinks customers want and what customers really want.

Agility, efficient services and business processes and a simplistic outlook on banking as a whole has been Capitec's competitive advantage since its inception.

Capitec uses a focused best cost provider strategy in combination with a cost leadership strategy for its Global One product. It is a very innovative company, making use of various technologies within its business model to optimise and simplify the Global One product. Simplicity and ease of use, as well as the efficiency of its technological processes add significant value to the customer base, leading to a distinctive competence. As it grows into a larger company, it is aiming at a broader target market and this will shift it to the left in Porter's generic model.

Technology has been at the forefront of Capitec's competitive advantage. Innovation and technology are infused throughout the company in a top down approach. This is what drives the business. Only the best and brightest developers and IT engineers are hired in order to develop innovative programs and applications to further cement Capitec as the technology leader in South Africa. Technology is a long-term component of its value chain and has been instrumental in achieving its strategic objectives, leading to the

development of an innovative technology-driven business model which resulted in a substantial competitive advantage.

Capitec's distribution channels have also created a competitive advantage through strategic partnerships with leading retailers. These gave customers easy access to money through the retailers' cash withdrawal systems. The strategic alliance with key partners allowed easy access to money, whereas in the past access to money was not possible, particularly within the low income earning market segment.

d.) Expansion into the rest of Africa

Capitec Bank was established in 2001. Its unique strategy and business model can be classified as a blue ocean strategy or disruptive innovation whereby the company transformed a market that existed, but none of its competitors capitalised on this opportunity. Capitec achieved this through simplicity, convenience, accessibility and affordability.

In order to determine just how effective the Capitec business model and strategic approach to banking would be in the rest of Africa, a three litmus test was conducted in order to determine the viability of such an expansion. The most important challenges facing Capitec were the unstable political and business environment as well as the shortage of ATMs. However, mobile banking has been very effective in South Africa as a result of Capitec's personalised service offering and there is no reason why it cannot work in countries such as Botswana, Namibia, Gabon and Nigeria. There has been much emphasis placed on the unbanked population of South Africa, which is about 52% of the total. The rest of Africa has an unbanked population of 80%. Through a disruptive innovation strategy, Africa would be a very viable expansion option for Capitec. Ventures (2012) states that due to the unstable business terrain and high unemployment levels on the African continent, Capitec will not be looking to expand into the whole of Africa, as its business model will simply not work. However, with that said, it has already been

established that a massive unbanked market exists and can be tapped into. Furthermore, several countries in Africa have a lower unemployment rate than South Africa.

Expanding into Africa is definitely an option that Capitec should explore in the not too distant future.

5.3 RECOMMENDATIONS

Although research has shown that Africa's climate is not suited for successful internationalisation, Capitec's innovative technology-driven business model would be suited for expansion to a few selected African countries where unemployment rates are lower than South Africa's 25.2%, examples are Botswana (17.8%), Namibia (16.7%), Gabon (16%), Nigeria (23.9%) and Mauritius (7.76%) (Trading Economics, 2013). The political climate within these countries is stable and research has shown that these countries have a lower unemployment rate than South Africa. This opens up an opportunity for banks such as Capitec that target the lower income segment of the banking market. The cultural fit between Capitec and Africa is better suited in the short term than the fit between the BRIC countries. This statement was confirmed in the case study on Equity Bank in chapter four.

Due to Capitec's customer-focused approach, customers of Capitec are able to conduct banking transactions at selected retail outlets, eliminating the need for ATMs, of which there is currently a shortage in Africa. Should Capitec expand into the aforementioned countries, it would need to adopt the same strategy as in South Africa, whereby leading retailers in each respective country are approached to provide access to funds for Capitec customers in place of ATM's. This expansion would provide the bank with a significant opportunity to grow.

The most efficient means of expanding across the borders into the rest of Africa would be for Capitec to acquire or merge with a bank that has a very similar business model and strategic approach, a bank that has won numerous accolades, and most importantly, a bank that has targeted the masses i.e. the unbanked. Equity

Bank and Capitec Bank can and should form a mutually beneficial partnership whereby they will be able to dominate the African banking environment.

In terms of a SWOT Analysis of Equity Bank, Capitec would be able to add value to Equity Bank's business model. One major weakness of Equity Bank is its lack of senior staff experience. Due to the business terrain in which their target market is positioned, this results in a high staff turnover (Abishua, 2010). There is also too much emphasis being placed on the CEO, James Mwangi, and it could tarnish the bank's reputation should there be some negativity towards him (Abishua, 2010). This is where the author believes that Capitec has strength, and it would be able to assist Equity bank in terms of visionary leadership and experienced management and staff.

Equity Bank displays many strengths. One particular strength that would be beneficial to Capitec, not only in the South African banking environment but also in the rest of Africa, is its one stop shop approach (Abishua, 2010). Capitec, as mentioned previously, will have to diversify and broaden its product range in order to compete in the red ocean. Currently, Capitec offers the Global One product, whereas Equity provides a range of different products and services. Due to its expanded product range, Equity Bank has a customer base of 35 million and is still growing (Abishua, 2010). The author believes that a merger with Equity Bank would provide numerous opportunities for product expansion and diversification, and would help them establish a presence in Africa more quickly than if they pursued a Greenfields investment strategy.

There are numerous opportunities for banks like Capitec and Equity to expand into investment banking, asset finance and corporate banking services (Abishua, 2010). By way of a strategic alliances or mergers, Capitec could grow into a market leader throughout Africa as well as South Africa.

In terms of the threats facing Capitec, economic recession will always be a threat, however, Africa presents a climate that is conducive to the cost effective banking offers of Capitec and Equity.

Capitec's current focus on the unbanked lower income segment is seen as a unique selling point. However, Capitec can compete successfully against larger banks by expanding its customer base by targeting the higher income earning market segment. By doing this, Capitec will not be risking its reputation as a low cost banking service provider and ultimately acquire a larger share of the market.

By offering services such as car finance and mortgage bonds, Capitec will increase its revenue and be able to expand its operations. The author believes that broadening its product range specifically to mortgage bonds will help Capitec attract a different market segment. Its value proposition has already been established, but it now needs to expand its business model to include other products that the big four banks are offering. By introducing new products gradually over several years, Capitec will be able to compete within the red ocean with less exposure to risks such as bad debts, and at the same time still focus on its core business.

South Africa is an emerging economy, and the ability to obtain finance for low cost housing is a major problem. Capitec could devise a strategy aimed at providing home loans to a market where the average household income is below the South African mean, a home loan product that is designed to meet the needs of the low income earning profile, just as it did with Global One. This would also facilitate the realisation of Capitec's strategy to grow the business by 55 branches a year over the next five years.

By expanding its customer funding model within the micro-lending market to a broader range of customers in the middle to high income earning market segment, Capitec would establish a competitive advantage and acquire a larger market share. Initial capital outlay would be higher in establishing the distribution channels but the long term benefits would outweigh the initial costs.

Capitec's technology-driven business model has proven to be very successful. As shown previously, competitors within the banking industry have adopted a similar approach by targeting the unbanked.

Capitec must implement a reward-based incentive program that rewards customers for doing their everyday shopping and for using Capitec, much the same as FNB's eBucks and Nedbank's Greenbacks. Furthermore, Capitec could go one step further and develop an incentive program that works in conjunction with its strategic alliances and KD.

5.4 FURTHER RESEARCH

Further research is required in order to determine an effective strategy for Capitec's international expansion to the BRIC countries, whereby an appropriate business model could be developed to suit each BRIC country taking into account the vast differences in culture.

According to CEO Riaan Stassen, Capitec does have plans to internationalise its operations, however this is in the long term. Its focus is to grow the company in South Africa first (Ventures, 2012). Plans to internationalise the brand would involve making acquisitions overseas or undertaking leveraged buyouts in countries outside the African continent (Ventures, 2012). Capitec could consider the possibility of entering the BRIC countries. According to Stassen, the developed world is not part of Capitec's international expansion plans. The reason for this is that the developed nations of the world have been affected by the economic downturn (Ventures, 2012).

In anticipation of its international expansion, Capitec has appointed Markus Jooste, CEO of Steinhoff International, as a non-executive director (Ventures, 2012). Jooste was appointed because of his international retail mind-set and he will be a great asset to the company when it starts the search for international opportunities (Ventures, 2012).

There is a need for more research by commercial banks such as Capitec on the microlending sector, where an investigation into the customer-funding model could be undertaken, aimed at entrepreneurs in general, and not just micro-entrepreneurs.

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ANNEXURE A

Nelson Mandela Metropolitan University

for tomorrow

FORM E

ETHICS CLEARANCE FOR TREATISES/DISSERTATIONS/THESES

Please type or complete in black ink

FACULTY: Faculty of Business and Economic Sciences

SCHOOL/DEPARTMENT: Business School

I, (surname and initials of supervisor) **Jonker, JA** the supervisor for (surname and initials of candidate) **de Lange, MC** (student number) **203003543** a candidate for the degree of **Magister in Business Administration** with a treatise/dissertation/thesis entitled (full title of treatise/dissertation/thesis):

A strategic analysis of Capitec Bank Limited within the South African banking industry

considered the following ethics criteria *(please tick the appropriate block):*

	YES	NO
1. Is there any risk of harm, embarrassment of offence, however slight or temporary, to the participant, third parties or to the communities at large?		x
2. Is the study based on a research population defined as 'vulnerable' in terms of age, physical characteristics and/or disease status?		x
2.1 Are subjects/participants/respondents of your study:		X
(a) Children under the age of 18?		X
(b) NMMU staff?		X
(c) NMMU students?		X
(d) The elderly/persons over the age of 60?		X
(e) A sample from an institution (e.g. hospital/school)?		X
(f) Handicapped (e.g. mentally or physically)?		X
(g) Socially/economically disadvantaged?		X
3. Does the data that will be collected require consent of an institutional authority for this study? (An institutional authority refers to an organisation that is established by government to protect vulnerable people)		X
3.1 Are you intending to access participant data from an existing, stored repository (e.g. school, institutional or university records)?		X

4. Will the participant's privacy, anonymity and confidentiality be disclosed/revealed?		X
4.1 Are you administering a questionnaire/survey that:		X
(a) Collects sensitive/identifiable data from participants?		X
(b) Does not guarantee the anonymity of the participant?		X
(c) Does not guarantee the confidentiality of the participant and the data?		X
(d) Will be distributed electronically (e.g. online via email/web link)?		X

*Please note that if **ANY** of the questions above have been answered in the affirmative **(YES)** the student will need to complete the full ethics clearance form (REC-H application) and submit it with the relevant documentation to the Faculty Ethics Co-ordinator.*

and hereby certify that the student has given his/her research ethical consideration and full ethics approval is not required.

SUPERVISOR(S) — 7 August 2013 **DATE**

pp HOP — 8/8/2013

HEAD OF DEPARTMENT — **DATE**

STUDENT(S) — 06/08/2013 **DATE**

Please ensure that the research methodology section from the proposal is attached to this form.