Weaknesses:

- The nature of the banks' business means there is significant dependence on IT systems, with compliance and core processing being the biggest priority, making innovation difficult and time consuming (KMPG, 2007). This is a key weakness compared to some of the new non-bank retail entrants as well as niche banks, which do not have these legacy systems slowing them down, and they are more easily able to innovate and develop different offerings that do not have to fit into cumbersome existing structures.
- The size of the traditional "Big Four" banks also makes them relatively inflexible and slow, with bureaucratic structures often inhibiting decision-making and speed to market. This is further exacerbated by the pervasiveness of multiple product silos within the banks, which can make strategy implementation difficult, with policy decisions moving slowly from the top down. Extensive bank branch structures are a high-cost operation and good cost efficiencies are hard to achieve.
- Some of the bigger banks also labour under a poor customer service reputation – banks are not always known for their customer focus, and are seen to have a rather dismissive "one size fits all" approach where customer needs are disregarded. Customers often feel like just a number, with the lack of personalised service being a significant frustration to customers who feel they have no control or real choice (SA Home Loans customer research, 2010). This poor perception is exacerbated by increased resistance to high bank fees, which are comparatively higher than most developed countries, and this provides a key advantage to smaller competitors who have seized on this as a key differentiator in their brand positioning.
- Another key weakness of the traditional banks is that they are all focused on the same market – the middle to upper income bracket – and this market is saturated. There is already a very high banking penetration amongst those earning over R2 000 per month. Banking is largely being supported by a relatively small proportion of the South African population The effort by banks to target the lower income levels – the "unbanked" – have not yet been successful on a large scale; however, this remains a key opportunity and political imperative for the future.
- Skills shortages and a lack of qualified and experienced staff remains a key concern for banks.

Opportunities:

- Growth is essential when it comes to poverty alleviation and banks are doing their utmost to reach the unbanked and those served by non-bank financial institutions.
- Technological innovation provides a massive growth opportunity for the banking sector. Technology is regarded as one of the key enablers of innovation. The majority of banks expect to invest significantly in technology over the medium term. Some banks have already achieved profitable revenue growth in the South African market by encouraging customers to migrate to electronic channels. Banks are seeking to leverage this experience as they expand across Africa.
- Expansion into Africa is also a major area of growth opportunity for local banks.

Threats:

- With the higher liquidity requirements of Basel 3, margins are being squeezed and the cost of doing business is increasing. This provides opportunities for non-bank competitors – who do not have to comply with the same banking regulations – to offer competitively priced products which the banks may not be able to match.
- Ongoing international regulatory requirements being introduced after the 2008 global financial crisis, volatile markets and the consequences of a protracted global recession, aggravated by structural difficulties in the Eurozone. Costs of compliance and regulation are high and increasing, which affects banks' profitability.
- Negative sentiment and declining investor confidence, motivated largely by labour unrest and uncertain policy positions in key sectors, compound these global pressures in South Africa and possible further downgrading of the country's credit rating.
- New entrants, such as large retail and telecommunications groups who already have well-developed customer relationship management systems but without the cumbersome legacy systems, have a clear opportunity to come in with innovative, disruptive products and distribution channels.
- The more customer-centric approach of retailers and telecoms companies, in addition to their extensive databases for customer analytics, gives them the opportunity to better meet customer needs and provide a significantly superior customer experience.
- With customers becoming increasingly fickle due to the commoditisation of banking products and a general scepticism of marketing claims, they are more willing to switch or try new lending products.
- Other threats include the risks attached to the recent strong growth in unsecured lending.

4.4. Current trends and challenges facing South African banks

The external business environment and local and international trends create both challenges and opportunities for banks. As part of the strategy process, bank executives need to stay abreast of these trends and challenges and ensure that their strategies and operating models are continually reviewed and realigned where necessary to the realities of a dynamic and changing environment. Banks adapting quickly to these changes will emerge as winners in the marketplace. Solutions must be found that encompass new business models, operating models, customer demands and legislative constraints.

Although not exhaustive, the following are some of the key trends and challenges currently facing the South African banking sector:[29]

Economic environment

The global economy is entering its fourth year of reduced growth, if not downright recession in parts, due to the aftershock of the banking crisis and ensuing financial chaos. Operating successfully in such a challenging economic environment requires a new approach from the banks. They are

29 Optimizing banking operating models *From strategy to implementation September 2012* kpmg.com *KPMG INTERNATIONAL*

still reluctant to lend money, despite political calls to lend more freely, and this scenario is not expected to improve. Currently, the low-interest environment has prevented more insolvencies from occurring during the recession. Once interest rates start to rise again, an increasing number of insolvencies could act as a further brake on lending.

Financially, the Eurozone is still in unprecedented crisis. If the US is dragged into the panic, a new world recession could follow. More banks will collapse, sending shockwaves through markets, further tightening credit and triggering more defaults and insolvencies. In developed economies, real income has not grown for six years. A consumer-led recovery is therefore highly unlikely. And as a further hindrance to growth, austerity measures in Western countries are depriving economies of massive levels of investment.

South Africa will be affected by developments in the international economic climate, since the inter-dependence of global financial markets has been a reality for decades now. The government and banks must do their utmost to minimise any contagion from global financial markets.

Changing customers

In the aftermath of the economic meltdown, banks are finding customers behaving more warily towards them. As well as the public bail-out of the banks, four years of 'bank-bashing' in the media and changing perceptions about the banking industry in general, mean that banks' reputations have never been lower. Customers are less trusting, less forgiving, and have higher expectations about how banks should do business.

Customers will feel further disenfranchised by the additional fees many banks will expect them to pay to offset the squeeze on banking profits. At the same time, cross-selling of products to existing customers remains the most effective way of increasing sales and retaining customers. Somehow, the trust lost during the global banking crisis must be won back, which could take four or five years.

The march of technology

Many banks are burdened with out-of-date IT systems. As competition heats up to win back customers and increase internal efficiency, systems will need upgrading across the board. Many banks are assessing core system upgrades to bring more flexibility and configurability to their product development and pricing capabilities. Banks increasingly recognize the value of leveraging data to optimise customer development as well as improving operational efficiencies in managing regulatory compliance and platform simplification.

Technology is further complicated by the rapid rate of change and the introduction of new channels and technologies, such as mobile banking and social media. The sheer pace of change suggests that IT architectures will require significant re-engineering to support a complete re-working of the traditional banking operating model. However, modernising IT architectures will require vast levels of investment.

While some banks understand the lead time and are making the appropriate level of investments, many banks are finding it difficult to support investments where the benefits may not accrue for many years and are often difficult to quantify. Their reluctance to drive forward a modernisation agenda should not therefore be surprising. But this same reticence to internally invest will leave banks lumbered with patchwork IT compromises, rather than the efficient and integrated systems they need to thrive in the new banking environment.

South Africa's banks have invested heavily in technology, making for the sophisticated system in place today, which allows for substantial cross-border transactions. It is behind the banks' drive to improve cost efficiencies, too. Technology will drive much of the change in the banking sphere; it is

a key enabler of innovation and banks' electronic channels should have a much larger role to play in the not-too-distant future. With new technologies and analytic capabilities available, there is much that can be done to pull customer information up and out of silos to begin creating a stronger understanding of not only who the customers are, but what their needs are and how they are likely to behave in the present and the future.

Mobile penetration is especially crucial in the technology space. It is expected that banks will reduce the number of traditional branches they operate, and direct more customers towards electronic (or self-service) distribution channels, which focusing more intensely on customer liaison within existing branches. This does not, however, mean that banks will necessarily reduce their staff numbers – on the contrary, they are expected to grow by about 2% between 2013 and 2016. Service quality and customer retention will become even more pressing in an increasingly competitive banking market – customer-centricity will drive strategy within banks to an even greater degree than before.

Regulation

The complex regulatory environment continues to pose challenges as banking executives indicate increasing concerns over the impact these requirements will have on growth and business models. Many bank executives highlight legislative and regulatory pressures as the most significant barrier to growth, while many believe political and regulatory uncertainty poses the greatest threat to their bank's traditional business model.

Regulation is an inescapable challenge and here in South Africa it is no different. The 'Twin Peaks' regulatory model that will be introduced from 2014 is of key concern to banks. Financial regulation is now encouraging banks to change their approach to transparency, market integrity and consumer protection. In effect, this means a separation of the prudential and the market conduct supervision of the financial sector. A 'prudential regulator' will be appointed as part of the SARB to enhance financial stability, focusing on the safety and soundness of regulated institutions. A 'market conduct regulator' will form part of a restructured Financial Services Board (FSB) to protect consumers and promote confidence in the sector.

Regulatory reform is regarded as the most significant development, most pressing issue, and most significant weakness in the banking industry. The sheer scope of current and planned reforms that will have an impact on the industry are top of mind for bank executives. Banks, insurers, financial intermediaries, retirement funds, administrators, investment institutions and financial markets will all be expected to operate within the new regulatory framework.

Remuneration of bank executives remains a hot topic as authorities continue to explore how best to regulate rewards in the international banking sector, with the aim of reducing excessive risk taking.

The increasing costs of regulatory compliance and impact on profitability is a key challenge for banks in the future.

Demographic shifts

Demographic shifts will have a large impact on economies around the world, and banks will need to anticipate changes and align products and services with a changing customer base. Developing economies are experiencing significant population growth, specifically in economically active segments. This creates an attractive market for deposits, lending and transactional banking.

Over the next 30 years, the urbanisation of 1.8 billion people will bring the global urban population to 5.6 billion. Urbanisation increases the stress on physical and service infrastructure, creating demand for investment that will support the migration of people into cities. Banks must tailor their service offerings for rural and urban populations. Urban populations have a higher demand for financial products and services. However, banks must continue to explore innovative ways of meeting rural customer needs. The sub-Saharan region is particularly appealing and key growth territories in Africa are worth watching (Nigeria, Ghana, Kenya). As more countries urbanise, so urban populations' needs for financial products and services will increase; at the same time, the rural base should not be neglected and coming up with innovative ways of meeting customers' needs should be a priority for banks.

The search for growth

Banks are looking at numerous ways to grow revenue, including new products and services and expansion into new geographies and customer segments. Cross-selling of services is viewed as a key growth driver in the years ahead.

Transformation and financial inclusion

Financial inclusion is a central aim of the banking sector, whereby the sector seeks to improve the range, quality and availability of financial services and products focusing on the unserved, underserved and financially excluded.[30] Principles of financial inclusion include; access, affordability, appropriateness, usage, quality, consumer financial education, innovation and diversification, and simplicity.

A number of initiatives launched by the sector are evidence of the banking industry's commitment to financial inclusion. The Financial Sector Charter (FSC) and the Black Economic Empowerment (BBBEE) Act have been the main pillars of transformation in the sector. Signed in 2003 and implemented in 2004, the FSC is a voluntary transformational charter for the financial sector.

The financial sector in general and the participants (financial institutions) in particular, are committed to 'actively promoting a transformed, vibrant, and globally competitive financial sector that reflects the demographics of South Africa, and contributing to the establishment of an equitable society by effectively providing accessible financial services to black people and by directing investment into targeted sectors of the economy'.

Participants are committed to transforming the sector in the areas of:

- Human resource development;
- Procurement of goods and services;
- Access to financial services;
- Empowerment financing (including targeted investments in transformational infrastructure, low-income housing, agricultural development and black SMEs as well as BEE transaction financing);
- Ownership and control; and
- Corporate social investment (CSI).

Finding ways to include the millions of economically active people in Africa who fall outside the mainstream financial sector is essential for banks' sustained profitability, and contributes to the broader socioeconomic development potential of the countries in which they operate. Affordability is a key requirement for unbanked customers. To reduce the cost of services, banks need to look at implement banking models that use low-cost distribution channels such as mobile banking, and work to create products that are affordable, accessible and simple to use.

30 *2012 South African Banking sector overview.*

Competition and technology in the payments system

The National Payment System is critical to South Africa's economy – each economic transaction is reflected thanks to this macro-system, so any changes to the system would have a huge impact on the economics of the country.

The system is a complex collection of rules, business and computer systems, cross checks and interventions, management control, and information feedback. The system does not operate quite as efficiently as it could, even though it functions well.

In South Africa, the establishment of rules for payment clearing and settlement is dominated by the four big banks. Representatives of the four big banks contributing to payment rules inadvertently have to balance the need for stability and collaboration with what is also protecting the interests of their banks. The South African payment associations have been very successful in creating a stable and predictable payment domain in South Africa. However, the rules serve to protect the big banks from new entrants, which is why the Competition Commission has seen fit to investigate what changes need to be made to the NPS, particularly when it comes to serving the needs of our essentially still developing economy.

The Competition Commission has suggested that pricing be made more transparent – pricing for payment services should be split into two components: the clearing of a transaction and the usage of infrastructure. Pricing should be visible, transparent and not different from one customer to another. A further suggestion is that continued investment in essential payment infrastructure should be controlled by central government rather than by banks, and managed and governed by means of a public commission or similar structure. Currently, rules protect those businesses that service more lucrative and 'First World' markets as they were established with developed nation interests in mind; this cannot prevail in South Africa, where much development still needs to take place.[31]

Emerging markets and Africa

Many banks recognise the growth potential in sub-Saharan Africa, which forms part of the SAAAME (South America, Asia, Africa and Middle East region). The financial crisis accelerated the rise in economic importance of SAAAME markets, as they continue to expand, while growth in many developed markets has stalled. Emerging-to-emerging market flows are growing at a much faster rate than the traditional routes, being developed-to-emerging and developed-to-developed markets. This new direction of flows brings great opportunities for banks in the SAAAME region as they have the advantage of being closer to this shifting epicentre of global trade and growth.

Africa is regarded as one of the key areas for growth within the SAAAME region, with six of the top 10 fastest-growing economies globally expected to be in Africa over the next five years. A significant proportion of this growth, including rapidly expanding trade flows, is being driven by the vast resources of the continent, as well as increasing economically active populations. PwC forecasts prolific population growth on the African continent, with the total population expected to exceed two billion by 2050. At that time, one in five of the world's young people, and the largest working-age population, will be in Africa. These growth rates are very appealing to business and certainly far greater than those forecast for South Africa. It is therefore not surprising that many bank executives regard the rest of Africa as a key area in which to unlock growth opportunities.

Most bank executives therefore expect an increasing percentage of their after-tax profits will come from the sub-Saharan region (excluding South Africa) in the medium term. Growth potential,

31 *www.compcom.co.za*

political stability, and the availability of quality local talent are important considerations for banks when expanding across Africa.

Economic growth in Africa is expected to outpace that of the world and advanced economies. While projected growth rates for the continent may be tempered by global economic troubles, the future growth trajectory looks robust and remains fundamentally linked to the global demand for resources. Trade with Africa has also increased significantly, and importantly, intra-Africa trade is on the rise. It therefore makes sense for local banks to consider the Africa opportunity when developing their strategies.

Emerging trends in African banking

Banks in Africa face various business challenges, including a growing pressure to maintain margins, meet evolving customer needs and managing portfolio risks effectively. Non-integrated reporting systems and a lack of process automation are challenges that need to be met head-on and banks must focus on improving operations in key business areas like trade, treasury and core banking.

According to the IDC's White Paper on Trends and Challenges in African Banking, some of the trends banks must be aware of include:

- Traditional corporate banks are expanding into retail banking to increase their funding base, as retail banking is an easy source of funding.
- Mergers and acquisitions are a growing trend as larger African banks seek to acquire smaller domestic market players when expanding into new markets.
- An increased penetration of banking products, such as access to finance, is a key growing trend. An example is banks in Botswana forming strategic alliances with telecommunications and insurance companies to encourage the use of money transfers and insurance products.
- Multiple banking channels targeting a wider customer market are a reality – this market consists of numerous existing and emerging customer segments. To meet customers' needs, banks must introduce newer products through various channels.
- Financial inclusion is critical for banks, and alternative-channel development may well facilitate the distribution of banking services. Improving poorly developed banking infrastructure and targeting the unbanked will drive bank strategy.

Market segment competitiveness[32]

The level of competition in banking is set to continue increasing, especially in certain market segments. According to the PwC report, corporate banking, flow businesses (foreign exchange and rates) and business banking are currently considered the most important wholesale market segments. Traditional retail banking (deposit taking and transactional banking), electronic banking

32 PwC 'Growing in an uncertain world. South Africa – major banks analysis'

and personal banking are presently considered the most important retail market segments. Retail banking is also viewed as the most intensely competitive market segment, and banks believe a fundamental change in strategy and positioning is required to compete aggressively in this segment.

Rapid expansion in unsecured lending is considered the second-most important development in the South African banking industry. Interestingly it was also considered to be the second-biggest weakness in the industry according to the PwC report.

Increased government interest in the banking sector

The relative under-performance of the South African economy compared to many other emerging markets has prompted the government to explore how the banking industry can play a more active role in stimulating economic growth. Banks are being encouraged to facilitate major infrastructure projects, such as funding rapid urbanisation and renewable energy projects, as natural resources continue to come under pressure. Government has frequently and clearly indicated that South African banks must ensure that the wider population has access to fair and cost-effective financial services, and facilitate their needs at an affordable cost. For a long time its message has been to bank the unbanked. It is therefore expected that government will increase its interest in the banking sector given this background.

Bank pricing under the spotlight

The Banking Enquiry was set up by the Competition Commission in 2006 to examine aspects of competition in the retail banking space. The enquiry focused on the concerns of small banks, prospective banks and non-bank players regarding competition in the national payments system, as well as the level of charges made by banks and other providers of payment services. This issue will be covered in more detail in chapter 5.

In summary, these trends create opportunities and threats for local banks. For the banks, top strategic priorities to adapt to these trends include regulatory compliance, improving asset quality, enhancing customer centricity, focusing on digital convergence, and tackling competition from non-banks. Banks therefore need to make business and technology investments to change their business models to comply with new regulatory requirements, enhancing capital adequacy, rolling out new channels such as social media, and leveraging customer data analytics and predictive analytics to enhance customer understanding and prevent fraud.

4.5. Banking markets

Banks in South Africa typically operate in the following banking markets:

- Retail (typically the consumer and small business markets)
- Private banking, i.e. the high net worth consumer market (also classified as part of the retail market)
- Commercial or business banking market
- Corporate market

Retail banking targets the **consumer and small business markets** and provides banking and other financial services to individual customers and small- to medium-sized enterprises. Services offered include transactional accounts, savings and investment accounts, loan products (for example personal loans, home loans, vehicle and asset finance), card products as well as insurance products and services.

Private banking typically offers personalised financial and banking services that are traditionally offered to the **high net worth consumer market**. Private banks focus largely on transactional banking and wealth creation and preservation services for wealthy individuals with a highly personalised service offering. Examples in South Africa include Investec Private Bank and RMB Private Bank. Many banks have private banking divisions within their retail banking structures while others have a separate subsidiary for private banking forming part of the overall banking group.

Commercial (or business banks) target the **business market**. They are similar to retail banks, but focus their products and service offerings on specifically serving the needs of the business banking (non-corporate) market. This market is normally made up of medium to large businesses that fall outside of ambits of the corporate market. They also offer transactional, saving and investments, lending and insurance services. Although some banks have separate commercial banking divisions or subsidiaries, most banks have included these business banking activities under their retail banking arms, often called personal and business banking.

Corporate and investment banks (also known as merchant banks) target the corporate market and typically provide banking services to governments, parastatals, larger corporates, multinational companies, financial institutions and international counterparties. Although they offer the standard banking products and services that retail banks offer, they serve their customers' local and cross-border requirements for banking, finance, trading, investment, risk management and advisory services. The importance of corporate banking is evident from recent operational changes seen in the industry, with the corporate and investment banking businesses of two of the Big Four banks being realigned. As at 2013, three of the Big Four banks now operate their corporate and investment banking segments as one combined business. This enables them to service corporate customers more holistically.33

Within each of these different markets, there are different customer segments. Banks use segmentation models and strategies to focus on these segments and to develop appropriate customer value propositions to serve the often unique needs of customers in the different segments.

According to the PwC 2013 South African banking survey:

Corporate banking, flow businesses (foreign exchange and rates) and business banking are the most important wholesale market segments.

Traditional retail banking (deposit taking and transactional banking), electronic banking and personal banking are the most important retail market segments.

Traditional retail is also viewed as the most intensely competitive market segment and banks believe a fundamental change in strategy and positioning is required to compete aggressively in this segment.

Segmentation

Banks segment customers within each of these different markets.

This is a strategy whereby banks divide their customer base into separate designated groups or target markets (called segments) which have similar characteristics based on key attributes, such as demographics, attitudes, or buying behaviours.

33 *PwC Report. Shaping the bank of the future South African banking survey 2013*

A bank's approach to segmentation needs to identify which segments will generate greater returns in the short, medium and longer terms to guide acquisition strategies that will ensure consistent and long-term returns.

The segmentation criteria used by banks to segment their customer bases are similar, but are driven by their respective strategies in the different customer segments. This will be covered in more detail in the next section.

4.6. Bank structures and strategy

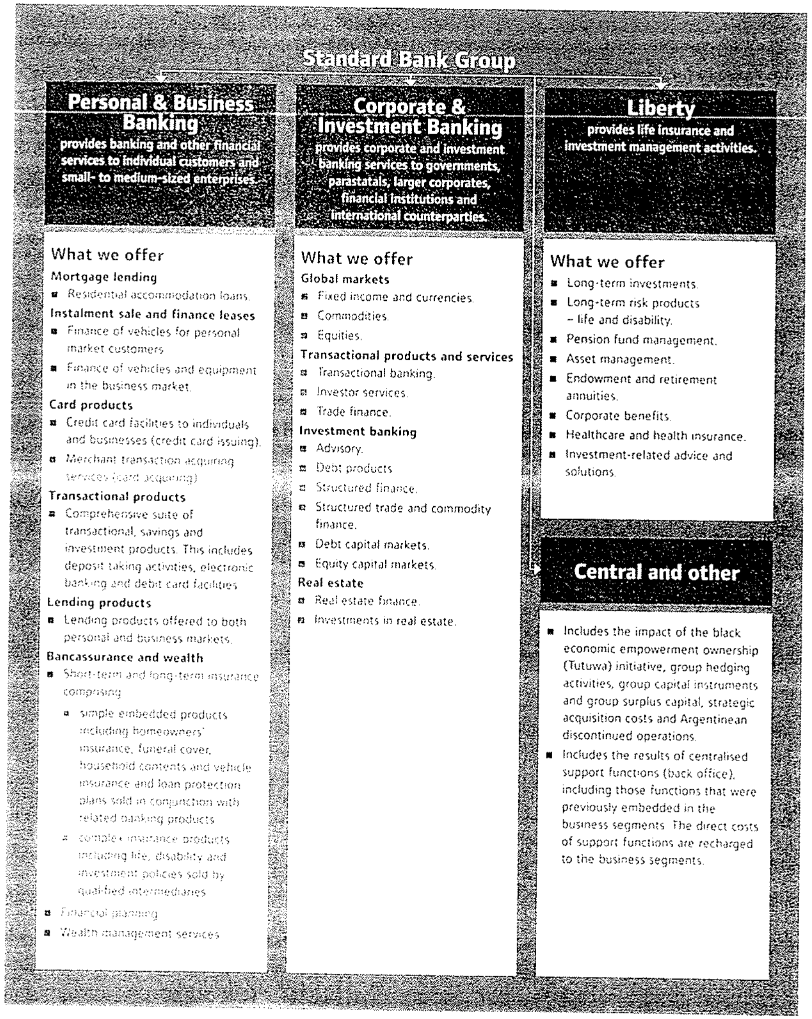
Structure follows and supports strategy.

Structure represents the way a bank's business divisions and units are organised, and includes the information of who is accountable to whom. In other words, structure is the organisational chart of the firm.

The structure of a bank needs to be totally integrated with and aligned to the strategy in order for the organisation to achieve its mission and goals. If an organisation changes its strategy, it must change its structure to support the new strategy.

Bank structures typically mirror the strategic intent of the respective bank, and whether they follow a universal or niche approach to the market. As discussed earlier, businesses typically follow a differentiation or cost advantage strategy, either within a broad target market or narrow (niche) market. Banks in South Africa are predominantly either universal (or full service) or defined as niche.

The following is the current structure of the Standard Bank group which reflects its full service or universal bank market positioning:



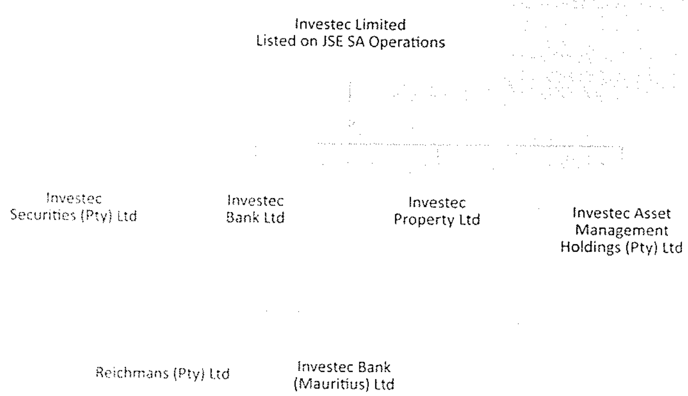
Universal banks, for example Standard Bank, FirstRand and ABSA, participate in many kinds of banking activities and provide a wide variety of financial services. They are normally both a retail (personal and business banking) bank, a corporate and investment bank, as well as providing other financial services such as wealth and insurance services. They normally offer transactional banking, savings and investment, lending, insurance, risk management, wealth management and advisory services.

Their strategic scope is therefore broad and they have to serve a broad range of markets and customer segments. Within this broad scope, they need to follow a cost leadership or differentiation strategy.

Niche banks, for example Capitec, Investec and Bidvest, cater to and serve the needs of a certain demographic segment of the population, whether in the personal, business or corporate markets. They typically follow a focus strategy, with either a strong low cost focus (as presently in the case of Capitec) or a differentiation strategy (for example Investec). Their organisational structures are supportive of these competitive strategies.

Current Investec structure

Investec's strategy to 'be recognised as a distinctive specialist bank and asset manager, and not to be all things to all people' is also reflected in its group structure, as depicted below. It focuses on serving the needs of market niches where it can compete effectively, predominantly in wealth and investment, asset management and private banking activities.



Business and operating models

A typical bank's overall strategic approach is visually represented below. The diagram provides a good overview of how banks approach strategy.

The diagram below will give a good general sense of how strategy is approached.

CATEGORIES	OBJECTIVE	INPUT	OUTPUT
STRATEGIC INTENT	What does the company stand for?	Shareholder value proposition Customer Value Proposition Employee Value Proposition	*A set of principles to guide future direction*
BUSINESS MODEL	What value will be delivered to which customers?	Product Strategy Channel Strategy Segmentation Strategy Operations Strategy Capabilities Required	*A set of principles and capabilities required for fact based decision making aligned with strategic vision*
OPERATING MODEL	How will we deliver value to customers?	Customer, channel interactions Capability definitions by product, process Operating Components	*Interactions between customers and channels, with business units and required operating components defined in terms of organisation, location and sourcing*
BUSINESS ARCHITECTURE Management HR Architecture Process Architecture Technology Architecture Process	How will we integrate the people, process and technology?	Human Performance Characteristics Process Characteristics Technology Components	*A business architecture, describing the process, technology and human performance characteristics the bank will need to implement for each capability in the operating model*

The strategy of a bank has been covered in some detail earlier in the textbook. What underpins and supports a bank's strategic intent is the business model, operating model and business architecture.

The business model of a bank

The business model is focused on driving revenue. It represents the value proposition to the customer and is made up of the products and services for which the customer will pay. Success will be defined by the degree to which customer needs are met. While the business model can be configured in a number of different ways, customer segment, product and channel are typical for many banks.

The business model defines what value will be delivered to which customers and typically comprises a bank's product, segment and channel strategies.

The strategic focus of the bank will be to identify the most profitable customer segments together with their needs and preferences in order to offer them the right products, at the right time, at the right price, through the most appropriate channel.

A key objective is channel-specific strategies that capitalise on the distinct role of each channel need to be developed – for example, low-cost internet services for everyday transactions, to appeal to customers who want easy access and convenience, and higher-cost branch or relationship management strategies to nurture large profitable customer relationships.[34]

The operating model of a bank

The term 'operating model' is an abstract representation of how an organisation operates across processes, organisational and technological domains in order to accomplish its function. It essentially answers the question of how strategy will be executed and how value will be delivered to customers.

An organisation is a complex system. An operating model breaks this system into components to improve understanding and provide opportunities for continuous improvement.

The operating model is focused on driving sustainable profit and comprises much more than just operations and technology. It is made up of all the functions required to support, control and manage the delivery of the products and services that make up the customer value proposition. Typically, these functions are not directly paid for by the customer, but might be integral to the product or services offered (business support functions). Alternatively, they are functions that are required to support, control and manage value creation for the bank itself (e.g. corporate or head office functions).

Whilst the appropriate alignment and sourcing of delivery capabilities (channel, operations and technology) is key, operating model considerations are far wider, and must also consider five core operating model functions: governance, risk and control; financial management; legal and physical structure; people; and reward and delivery (operations and technology).

For many banks, regardless of any changes to their business strategy, the way that strategy is delivered, i.e. the operating model, will most probably have to change. Going forward, the increased costs of capital and liquidity will have an impact on both revenues and profitability in the industry - therefore structural (operating model) changes will be required to ensure compliance with emerging regulation and to achieve the necessary efficiencies that can drive acceptable returns to shareholders.

The role of segment, product and channel within banks

Within the typical bank business model, there are three important functions that are worth highlighting, i.e. customer segment functions, product functions and the (customer) channel function.

The segment function takes on the lead role to develop the customer segment value propositions, while the product areas innovate, and channels manage the customer interface and experience.

34 *PwC's Getting to Know You: Building a Customer-Centric Model for Retail Banks*

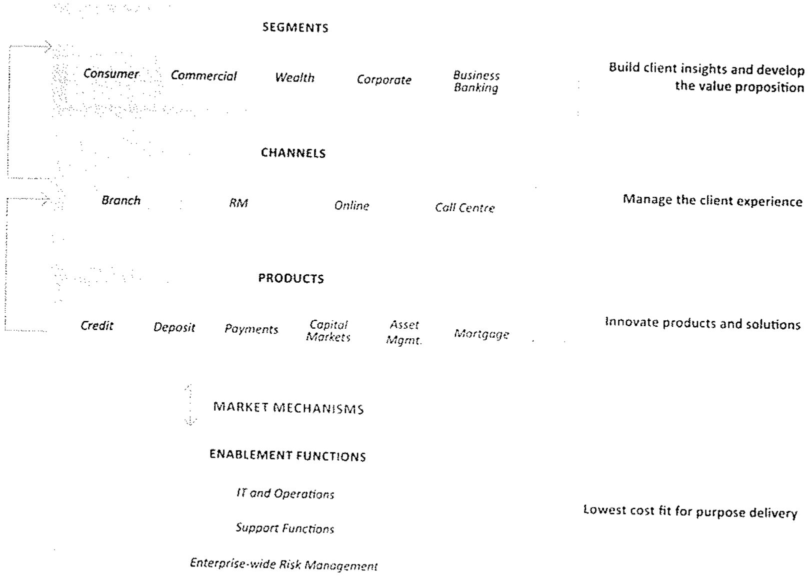
Segment develops customer insights and relationships. They use these customer insights, whether obtained from internal customer data analytics or from external market research, to develop segment strategies and value propositions, and defining the pricing, product, sales and service models, as well as the risk management strategies for the different customer segments.

Product areas are primarily responsible for the design, development, implementation and support of a bank's product lines. They are responsible for the pricing structures at an individual product level, tactical pricing and managing product profitability. They also need to provide support to the sales functions through training, sales guides, incentives, marketing, etc. Bank product areas are typically structured according to transactional, savings and investments, lending and insurance products. They also need to integrate risk and compliance management into their product and pricing strategies.

The channel function essentially 'owns' and manages the customer relationships across the different segments. They are often referred to as the 'frontline'. They are primarily responsible for sales and customer service, and ensuring that risk and compliance requirements within a set risk and compliance management framework are adhered to. They are normally also responsible for customer channel management, which includes physical channels (like branches, ATMs, service centres, etc.) as well as self-service channels like internet banking. Channels will be covered in more detail during the next chapter.

The clear roles and responsibilities of these three areas result in a more integrated, flexible and customer focused operating model.

Integrated relationship driven operating model



Finally, delivery platforms or 'enablers' need to be in place to successfully execute and deliver on the strategy. These enablers comprise the shared services or group enablement functions of a bank which comprises IT (technology) and operations, risk management, and other support functions such as human resources, finance, and learning and development.

Enablers	Description
Operations	• Streamline end-to-end processes by taking a customer-back view to meet customers needs • Create accountability and ownership for end-to-end processes to deliver desired customer experience • Build process utilities (e.g. for customer lending) by leveraging common processes to build scale and expertise
Technology	• Build customer management capabilities that enable relationship strategy (e.g. end-to-end workflow) • Simplify current application complexity to deliver superior customer experience • Create consistent data architecture to enable creation of client insights (e.g. 360º customer view)
Risk	• Build robust risk management governance aligned to lines of business (LOBs) • Embed process to set risk appetite and respective risk tolerance/ targets/limits on LOBs and also at the department and product level • Enhance capabilities to manage risk across the organisation
Support functions	• Create strong support and business partnership aligned to the new operating model • Build support function shared services to capture scale and expertise required to deliver services efficiently and effectively

Business architecture

The Business Architecture Institute defines business architecture as:

"A blueprint of the enterprise that provides a common understanding of the organisation and is used to align strategic objectives and tactical demands."

The business architecture of a bank answers the question of how people, processes and technology will be integrated to support the capabilities required by the operating model.

Business architecture enables a sustainability bank strategy by serving as the link between strategy development and execution.

Banks have to adopt new architecture for their core banking systems, to integrate the roles of people, processes and technology into one seamless system. Core systems have previously been developed according to a product-centric design philosophy, emphasising operational support for a product, product line or specific financial services. But the go-to-market model may need to be changed, so that more factors can to be taken into account: front- and back-office capabilities, regulations, cost reductions, IT development and so on.

The typical components of business architecture within a bank comprise the following:

- Business processes and capabilities (including business rules)
- IT and technology architecture
- Human resources architecture

4.7. An overview of different strategic approaches within South African banking

Banks' strategies and their approach to the market are continually being reviewed and realigned to ensure that they remain competitive. Strategies are dynamic in nature and bank executives regularly need to re-evaluate and adapt their strategies based on changing market dynamics and internal challenges.

The banking industry specifically is more complex now than it was a decade ago. At the same time, a number of trends and developments are currently shaping the global landscape for financial services, and in particular the banking industry. Some of these emerging trends were discussed earlier in the chapter.

Based on interviews held by PwC in their report *'Shaping the bank of the future: South African banking survey 2013'*, local bank executives confirmed these emerging trends and the resulting impact on their organisations. They were also positive about their respective organisations' ability to respond to these trends. In many instances, tactical solutions have already been implemented in response to short-term changes, while some organisations have started to implement more fundamental strategic changes to capitalise on longer-term opportunities.

To close off this section on markets and strategy, it is useful to provide some context on how the different South African banks follow different strategies.

On the next few pages is a high-level overview of the current strategies of some of the players in the South African banking industry as at 2013. (Sources: Bank websites and annual reports)

Barclays Africa Group Ltd (previously ABSA)	
Type of bank	Full service bank
Date established	ABSA - 1991 (through the merger of UBS Holdings, the Allied and Volkskas Groups, and certain interests of the Sage Group) Barclays Africa – 2013 (through combining Absa Group Limited and Barclays' African operations)
Profile	Absa Bank Ltd. (Absa Bank), with preference shares listed on the JSE Limited, is a wholly-owned subsidiary of the Barclays Africa Group. They offer a range of retail, business, corporate and investment banking, and wealth management products and services primarily in South Africa and other African countries
Representation	Registered head office is in Johannesburg, South Africa. Majority stakes in banks in Botswana, Ghana, Kenya, Mauritius, Mozambique, Seychelles, South Africa, Tanzania (Barclays Bank Tanzania and National Bank of Commerce), Uganda and Zambia. Also have representative offices in Namibia and Nigeria as well as bancassurance operations in Botswana, Mozambique, South Africa and Zambia.
Vision	To become the 'Go-To' bank in Africa
Competitive Strategy	Broad scope; Differentiation
Strategic goals and objectives	Becoming the 'Go-To' bank in Africa through their One Africa strategy. Goal is to build not only a sustainable, trustworthy business, but a business that customers and clients consider as the first choice for solutions in Africa – their 'Go-To' bank. Differentiate themselves through relentless focus on service and targeted innovation to grow sustainably. Strategic themes: • Sustainable growth. • Build-out the platform • Customer and client at the core • People centricity • Control and compliance
Values	Respect (We respect and value those with work with, and the contribution that they make); Integrity (We act fairly, ethically and openly in all we do); Service (We put our customers and customers at the centre of what we do); Excellence (We use our energy, skills and resources to deliver the best, sustainable results); Stewardship (We are passionate about leaving things better than we found them).
Key differentiators Note: These are not communicated – input based on market perception	Barclays alliance; Size (2nd largest bank in Africa); extensive and established distribution network and Africa presence via Barclays; access to global product knowledge with regional expertise

Capitec	
Type of bank	Niche bank (focused on the South African personal market)
Date established	2001
Profile	Capitec is a bank controlling company that is listed on the JSE Limited. Operates as a retail bank providing innovative transacting, saving and unsecured credit products to individuals
Representation	South Africa
Vision	To provide essential banking services to all South Africans.
Competitive Strategy	Narrow scope; Cost focus
Strategic goals and objectives	Strategic objectives • Provide unique service • Enhance the product offer • Grow transaction income • Manage the cost of credit to clients Responsible management of regulatory and compliance risk grow transaction income; manage the cost of credit to customers; responsible management of regulatory and compliance risk.
Values	Respect diversity; have integrity; be straightforward and transparent; take ownership; be supportive.
Key differentiators Note: These are not communicated – input based on market perception	Low-cost focus strategy through leveraging technology and innovation to simplify banking. Unique bank system focused on making banking as easy, convenient and affordable as possible for a niche segment.

FirstRand	
Type of bank	Full service bank
Date established	1998
Profile	First Rand Limited, also referred to as First Rand Group or as FirstRand Bank, is a financial services provider in South Africa that provides banking insurance and investment products and services to retail, commercial, corporate and public sector customers.
Representation	South Africa, with subsidiaries in Mozambique, Lesotho, Namibia, Zambia and Botswana.
Vision	To be the African financial services group of choice, creating long-term franchise value and delivering superior and sustainable economic returns to shareholders within acceptable levels of volatility
Competitive Strategy	Broad scope; Differentiation
Strategic goals and objectives	Becoming a predominant player in all of the financial services profit pools in South Africa, growing in existing markets and those where it is under-represented; and growing its franchise in the broader African continent, targeting those countries expected to show above average domestic growth and which are well positioned to benefit from trade and investment flows between Africa, China and India.
Values	Respecting and empowering individuals; collective and individual accountability; integrity in our care for the business; prudent and accurate scorekeeping; being a good corporate citizen; helping to create a better world that is socially and environmentally viable.
Key differentiators Note: These are not communicated – input based on market perception	Entrepreneurial owner manager culture and strong track record for entrepreneurship and innovation

Nedbank

Type of bank	Full service bank
Date established	1888
Profile	Nedbank Group Ltd. is a bank holding company listed on the JSE Ltd. It provides wholesale and retail banking services, insurance, asset management and wealth management to its customers. Principal banking subsidiary is Nedbank Ltd. Old Mutual plc is the majority shareholder, owning 52% of the group
Representation	South Africa, with subsidiaries in Malawi, Namibia, Lesotho and Swaziland. Pan-African banking alliance with Ecobank Transnational Inc for West and Central Africa, providing clients with access to 36 countries across Africa
Vision	Building Africa's most admired bank by our staff, customers, shareholders, regulators and communities.
Competitive Strategy	Broad scope; Differentiation
Strategic goals and objectives	Repositioning retail; optimising portfolio tilt; growing non-interest revenue; expanding in Africa; client centred approach; fulfilling the bank's social purpose
Values	Integrity; respect; accountability; pushing beyond boundaries;
Key differentiators Note: These are not communicated – input based on market perception	Historical strength in wholesale banking, corporate banking and commercial property finance; reinvigorated corporate culture; pan-African footprint through alliance with Ecobank;

Standard Bank

Type of bank	Full service bank
Date established	1862
Profile	Standard Bank is listed on the JSE since 1970, has a 150-year history in South Africa and started building a franchise in the rest of Africa in the early 1990s. It offers transactional banking, saving, borrowing, lending, investment, insurance, risk management, wealth management and advisory services.
Representation	Operates in 18 African countries, including South Africa, as well as in other selected emerging markets. Owns a controlling stake in the South African listed insurance company, Liberty Holdings Limited
Vision	To be the leading African financial services organisation using all its competitive advantages to the full.
Competitive Strategy	Broad scope; Differentiation
Strategic goals and objectives	Embed customer and client centricity; inspire and motivate our people; achieve operational excellence; capitalise on strategic partnership with ICBC (capitalizing on growing business, finance and trade flows between Africa and China); deliver as a relevant corporate citizen; reshape our business to take account of trends in global legislation and regulation.
Values	Serving our customers, growing our people, delivering to our shareholders, being proactive, working in teams, guarding against arrogance, respecting each other and upholding the highest level of integrity.
Key differentiators Note: These are not communicated – input based on market perception	Strong brand presence and reputation; size and financial strength (largest bank in Africa); extensive distribution network in Africa; strategic partnership with ICBC (world's largest bank); strong sector experience, particularly in natural resources

It is also useful to know more about the Investec Group, the largest specialist banking and asset management group in South Africa and one of the niche banks in the local banking industry. The following summary represents extracts from the bank's website as at December 2013:

Investec is an international specialist bank and asset manager that provides a diverse range of financial products and services to a niche client base in three principal markets, the United Kingdom, South Africa and Australia as well as certain other countries. The group was established in 1974.

Investec focuses on delivering distinctive profitable solutions for its clients in three core areas of activity namely, asset management, wealth and investment, and specialist banking.

In July 2002 the Investec group implemented a dual listed company structure with listings on the London and Johannesburg Stock Exchanges.

Stated group strategy

Our strategic goals and objectives are based on our aspiration to be recognised as a distinctive specialist bank and asset manager. This distinction lies in our entrepreneurial culture, which is balanced by our strong risk management discipline, client-centric approach and ability to be nimble, flexible and innovative.

We don't try to be all things to all people. Instead, we aim to build well-defined, value-added businesses that serve the needs of market niches where we can compete effectively.

Our strategy for the past 20 years has been to build a diversified portfolio of businesses and geographies to support clients through varying markets and economic cycles. Since inception we have expanded through a combination of organic growth and strategic acquisitions. In order to create a meaningful and balanced portfolio we need proper foundations in place which gain traction over time.

Strategic focus

Customer-focused approach

- Customers are at the core of our business
- We strive to build business depth by deepening existing customer relationships
- High level of service by being nimble, flexible and innovative

Specialised strategy

- Serving select market niches as a focused provider of tailored structured solutions
- Enhancing our existing position in principal businesses and geographies through organic growth and select bolt-on acquisitions

Sustainable business

- Contributing to society, macro-economic stability and the environment
- Well established brand

- Managing and positioning the group for the long term
- Balancing operational risk with financial risk while creating value for shareholders
- Cost and risk conscious Strong culture
- Strong, entrepreneurial culture that stimulates extraordinary performance
- Passionate and talented people who are empowered and committed
- Depth of leadership
- Strong risk awareness
- Material employee ownership

Our current strategy

- Maintain momentum in asset management
- Internationalise our wealth and investment business
- Simplify the specialist banking business model
- Leverage our extensive customer base through greater utilisation of our products and services across the group
- Continue to attract new customers, extending the depth and breadth of the franchise

Our long-term internationalisation strategy

- Follow our customer base
- Gain domestic competence and critical mass in our chosen geographies
- Facilitate cross-border transactions and flow

Philosophies

- Single organisation
- Meritocracy
- Focused businesses
- Differentiated, yet integrated
- Material employee ownership
- Creating an environment that stimulates extraordinary performance

4.8. Conclusion

In this chapter you have been introduced to the fundamentals of banking strategy and an overview of banking markets.

Without a clearly formulated and well executed strategy, a bank cannot create the required competitive advantage required to succeed and remain sustainable in an extremely competitive industry.

In the next chapter we will introduce you to undoubtedly the most important factor when considering banking strategy – the customer. Banks ultimately exist because of and for their customers.

Banks around the world are facing intense margin pressure, slow balance sheet growth, an uncertain economic outlook and a growing threat from new entrants. Banks are also confronted with growing regulatory costs and increasing demands for greater fairness and clarity in their interactions with customers.

All of these factors are encouraging banks to increase their focus on their most important stakeholders —their customers. In this environment, understanding customer behaviour, attitudes and requirements is more vital than ever for banks' strategic thinking, operational planning, and day-to-day customer engagement.

Chapter 5
The Customer

5.1. Introduction

Banks exist because of their customers – as mentioned earlier, their role and core business as financial intermediaries is reliant on bringing together customers who either have surplus funds or customers that require funds – serving customers is therefore at the heart of their business.

Their entire business, whether it be branches, head office areas, operations or marketing, is ultimately focused on meeting the financial needs of the their customers in a way that differentiates them from the competition. Carl Fischer, Capitec's marketing and corporate affairs executive, was quoted as follows: "People need banking, not banks" (quoted in *The Bank of the Future*, BANKSETA), which indicates that banks need to be relevant to their customers, able to speak to them and listen to their needs. Too often, banks push products, which is why many banks are perceived to be product-focused rather than customer focused.

Bank customers globally are becoming less loyal to their banks. In South Africa, customer attrition in banking has increased. Attracting and retaining customers is vital to a bank – if a bank is losing customers, it may have to rethink its strategy and value proposition, as it is clearly not giving its customers what they want and opening the door for competitors.

Banks around the world are facing intense margin pressure, slow balance-sheet growth, an uncertain economic outlook and a growing threat from new entrants. Banks are also confronted with growing regulatory costs and increasing demands for greater fairness and clarity in their interactions with customers.[35]

All of these factors are encouraging banks to increase their focus on their most important stakeholders – their customers. Unfortunately, as banks are only too aware, customers who are losing trust in the industry heavily outnumber those who are feeling more confident.

As consumers become increasingly sophisticated and informed, demanding more personalised solutions to their financial needs, banks have to evolve to meet these demands. To fail to do so is to ignore the fact that we are living in the 'age of the customer'. The Consumer Protection Act (CPA) has strengthened consumer rights significantly, allowing consumers to gain a distinct advantage when dealing with suppliers – customer advocacy is a force that is gaining increasing power worldwide.

This is good news for customers, but it can also be good news for banks, as it forces them to improve their competitiveness and enhances business sustainability.

In this environment, understanding customer behaviour, attitudes and requirements is more vital than ever for banks' strategic thinking, operational planning, and day-to-day customer treatment.

35 *Global Consumer Banking Survey*