Offices across Asia, Africa
and Latin America

www.*MicroSave*.net
info@*MicroSave*.net

Innovative Approaches to Delivering Microfinance Services:

The Case of Capitec Bank

Gerhard Coetzee

August 2003

Innovative Approaches to Delivering Microfinance Services: The Case of Capitec Bank

Gerhard Coetzee

Executive Summary

Capitec Bank, a profit motivated South African owned microfinance institution provides a range of financial services to a clientele referred to as the "unbanked" in South Africa. The emphasis in this story of innovation is the corporatisation process, which has taken place over the last four years, rather than outreach and sustainability.

The establishment of this Bank took place at the same time when two South African microfinance banks collapsed. As a result both investor and depositor confidence was at a low. Despite this, this Bank headed by a dynamic group of Stellenbosch based businessman, have achieved significant milestones since inception.

The Bank was established in various stages starting out with the acquisition of a few micro lending businesses in Johannesburg. This enabled the development of a better understanding of the microfinance market through experimentation. Acquisitions 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[1]. On the operational side, the number of employees increased from 50 to 1 301 by 28 February 2001.

The story of Capitec Bank started when a decision was made by a group of businessman to focus solely on servicing clients in the lower income sector of the South and Southern African market. This service would be aimed at providing individuals and small businesses with a range of banking facilities, which are economical and affordable and are based on individual risk profiles, taking cash flow and ability-to-pay-models of risk evaluation into consideration.

In order to accomplish this, the need to apply for and acquire a banking license and to increase share capital, became a necessity and priority. This lead to the restructuring and incorporation of the business of Keynes Rational into The Business Bank Limited (TBB) on 1 March 2001. The name has subsequently been changed to Capitec Bank Limited. Keynes Rational was renamed Capitec Bank Holdings Limited in February 2002. The company was listed on the Johannesburg Stock Exchange on 18 February 2002.

The bank consists of three divisions, FinAid, Capitec and Capitec CBS. Each has a slightly different focus, although the Capitec brand has been very successful and the bank will be converting FinAid branches to Capitec brand in the near future. This will lead to the closure of one of the three divisions.

At present, the FinAid division focuses on Living Standard Measure (LSM) 3 to 5 (Average annual household R12,432-R25,344) and provides one basic short term micro loan product to approximately 100,000 individual clients. These individuals may have bank savings accounts but are unable to obtain traditional bank loan finance. The term of loans granted is 30 days, and the amounts vary up to R10,000, seldom exceeding R2,500, with an average of R600. Interest rates vary, depending on the branch history, but are typically set at between 21.5 and 30 percent per month. Distribution of the product occurs through a network of 262 branches.

The Capitec division focuses on providing financing through a more structured environment to a target market falling into the LSM 4 to 7 (Average annual household R17,628-R87,540) income-earning

---

[1] South African Rand R.7.80: US$1.00

profiles. The existing client base consists of approximately 20,000 clients. The Capitec Division is in the process of rolling out systems which allow the division to operate as a deposit-taking and lending operation with a card issuing facilities distributed throughout 55 carefully selected outlets in the bigger metropolitan areas of South Africa. These outlets all have a Capitec ATMs and branches have an open, modern appearance.

The Capitec CBS division provides commercial, unsecured loans on the stock required for the running of Small, Medium and Micro Enterprises (SMMEs) in the informal market place. The loan size is determined based on a specific business's acquisition profile through its traditional supply chain, where Capitec CBS finances a load of stock until repayment is made upon the sale of the load of stock. As a spin-off, the commercial market is addressed through the Capitec retail distribution infrastructure by using the branch infrastructure as a transaction platform.

In order to undergo the transformation from various independent micro lenders to a unified corporate microfinance institution that unfolded throughout the acquisition drive, Capitec decided on four key focus areas in their delivery strategy. *Accessibility* in terms of operating hours and location choice, *affordability* of the service they provide in terms of interest rates and transaction fees, *face-to-face service* in the client home language whenever possible in line with personal service that clients may previously have received and *simplicity* during the application process and transactions thereafter. Operationally, these four pillars form the core base of the business. The Product Range, Human Resources and MIS Systems have all been developed around this core. The functionality of these systems can be considered one of the most important management achievements.

During the transformation from more than 300 individual micro lending businesses to one corporate bank, Capitec has not only successfully managed to maintain the majority of their clients, but have also expanded their portfolio.

In excess of 500 new staff have been employed since the start of the corporatisation process. Extensive training of new and existing staff has been carried out. The training of existing staff also included a substantial component around change management with focus on Capitec's corporate image and vision. A carefully designed uniform IT system has also successfully been included in this transformation process and aided in unifying the various entities.

The four key goals that Capitec strives to achieve have been met according to the objectives they have set and have lead to an MFI that provides consistently efficient, good quality service to their clients.

The Bank's challenges for the future rest in the consolidation of what they have been striving for thus far. This will include firmly establishing their corporate image and the conversion of FinAid branches to Capitec branches. The expansion of their product range and the related operational and other issues that arise from new product development will also require some work from the institution. The key challenge still lies in the development of the trust relationship with their market and with investors, in which will potentially improve their capital position.

This customer-focused approach is evident in all facets of the business, whether they be product design or design of MIS and IT system. The fact that unsophisticated clients are not swamped with technology and paper, reflects an understanding of the client profile and preferences. MFIs should take their cue from Capitec's intimate knowledge of the market. Both its products and delivery systems reflect a good understanding of the market in which it operates. However, another important learning experience is the structured and focused way in which branches have been pulled into the Capitec system and culture.

TABLE OF CONTENTS

Innovative Approaches to Delivering Microfinance Services:
The Case of Capitec Bank

Gerhard Coetzee

1. Introduction

Over the last decade the microfinance world has changed tremendously. Many innovations have come to the fore and the outreach and sustainability of many institutions has improved. However, over the same period many institutions have struggled to remain sustainable, and for most of these, even operational self-sufficiency is unattainable. ***MicroSave*** strives to improve financial services for poor people. This series is an effort to share the lessons and achievements of innovative and successful institutions with a wider audience.

In this paper examines Capitec Bank, which started out as a number of independent micro-lending institutions, which were largely focused on consumer finance. This loose collection of micro-lenders was transformed into one institution, further developed into a licensed commercial bank, listed on the Johannesburg Stock Exchange and is currently innovatively expanding products to include savings and the financing of Small, Medium and Micro Enterprises (SMMEs). It is a story of institutional growth, formalisation, and the development of products, which serve clients with what they want, where they want it.

The context within which Capitec started out is significant. Only by understanding this context, can one understand the determination with which Capitec's founders and architects have stuck to their goals. Section two is devoted to painting a picture of this context. In section three, the Capitec model and history are described in detail, while section four reflects the performance of the institution. The last two sections look at achievements and challenges, while the conclusion ties the story together. It is important to note that Capitec is a new institution, formed out of a collection of institutions with long track records. The emphasis in this story of innovation is the corporatisation process, rather than outreach and sustainability. However, the latter two aspects are dealt with and they illustrate the objective of the founders. This objective is to be a profit-driven microfinance institution, which provides a wide range of financial services to a clientele known as the "unbanked" in South Africa.

2. Context

2.1 The economy

South Africa has a well-diversified economy where the services sector accounts for nearly two thirds of economic activity. The economic growth rate declined until the political reforms, which took place in the early 1990s. Since the 1990s, political changes and prudent financial and economic management have led to positive economic growth, slowly increasing growth rates and a generally positive economic outlook. This is especially true when South Africa is compared to other developing countries. After the near collapse of the Rand some 12 months ago, the currency has recovered to a level near to its internationally accepted valuation. Unemployment is still high, of a structural nature and results from the fact that service-oriented economies require skilled workers, which are in short supply in South Africa. Over the last decade, the SMME sector has grown tremendously, and is now contributing to nearly 38% of South African GDP and engaging nearly 50% of the economically active population. This sector of the economy faces many constraints, one being the rigid rules and regulations which hinder the creation and operation of SMMEs, another, the lack of access to financial services.

South Africa's financial sector is viewed as well developed for a third world country. Its commercial banking sector serves the population from 45 banks with approximately 3,600 branches. Roughly the same number of international banks have a presence in South Africa, however, they have negligible emphasis on retail financial services. Near to 90% of bank assets and the banking market are concentrated in the hands of four big local banks. These banks all have international presence and three of them have a solid presence on the African continent. Unfortunately, the conventional commercial banking sector does not offer a broad range of financial products to the poor. Until about eight years ago these banks provided savings facilities to the poor, but little more. They are mostly urban-based and continue to show a decline in rural banking facilities through a process of branch closure.

Recently, conventional commercial banks started showing an interest in the microfinance market when several of them acquired part or full ownership of microfinance entities. Some have also engaged in joint ventures or strategic partnerships. The banks have learned many lessons regarding the reality of the microfinance market in South Africa. Commercial banks have much to learn about this market, and in the wake of some failures in the microfinance sector many of them have become apprehensive about their microfinance portfolios. The microfinance portion of the broader financial market is undergoing an interesting development phase at present. Microfinance-focused institutions are continuously trying to broaden their market presence through improvement of systems and technology. Commercial banks are also interested, but not entirely sure of the most appropriate strategies. This has led them to act in a contradictory manner. For example, some commercial banks are increasing their exposure to the microfinance market, while simultaneously making it more difficult for small savers to open accounts through raising hurdles in the form of more stringent account opening criteria, minimum balances and branch-closures in poorer areas.

The recent failures of institutions in the microfinance market in South Africa have increased the perception of risk of microfinance institutions. In both cases, the failed institutions were owned by, or were commercial banks and thus publicly listed companies. This created a loss in confidence in commercial banks engaged in microfinance activities in South Africa. After the failures earlier this year, many of the smaller niche banks returned their licences for receiving deposits to the Registrar of Banks. The reasons cited were the cost of maintaining a licence and the risks associated with so-called small "A2" banks. It is clear that Capitec established itself during a period of risk, and listed on the Johannesburg Stock Exchange in a period where investors had little appetite for investment in microfinance ventures.

Microfinance players in South Africa are asking many questions, especially regarding whether appropriate regulation is needed. Many argue that no amount of banking regulation will fully prevent failures in the micro-lending field, and indeed in general, in the banking field.

The position of small banks in South Africa has been damaged not only by the incidence of bad debts in the micro-lending sector, but also by other negative, but fundamental factors. Low economic growth has restricted the growth of banking markets, while small banks in general have had to rely heavily on wholesale banking deposits. Poor saving ratios in South Africa have caused small banks to struggle to tap into deposits. In addition, the concentration of power in the South African money market, means that small banks face an entrenched competitive disadvantage.

There has been much controversy surrounding the refusal of the authorities to assist Saambou (one of the failures early in 2002) with its liquidity problems, forcing it to go into curatorship. The authorities are wary of being perceived as being too generous in acting as a lender of last resort. They fear that by bailing out banks too readily, they will encourage reckless banking practices. Even so, it is one of the Reserve Bank's roles to stabilise the banking system by acting as a lender of last resort, both for healthy banks that experience temporary difficulties, and for banks that pose a risk to the rest of the banking system.

In recent times, changes in monetary policy arrangements in South Africa have seemingly been influenced by the desire to bolster the competitive position of small banks. However, it can be argued that recent difficulties besetting small banks, which have partly arisen from mutations in the lender of last resort policies of the Reserve Bank, have badly shaken confidence in small and even medium-sized banks. This, in turn, has boosted the already strong position of larger banks.[2]

Against this backdrop Capitec's initiative is not only daring but also unique. Capitec will not only have to establish itself in the market as a viable concern in order to be able to attract sufficient funding for its projected portfolio growth, but will also have to establish a trust relationship with the public in order to attract deposits.

2.2 The microfinance "market"

Until 1992 microfinance institutions in South Africa consisted mainly of state-supported financial retailers or development finance institutions (DFIs) and non-government institutions (NGOs). The DFIs mostly operated at provincial level, while the NGOs were spread around the country. Both DFIs and NGOs declined in importance as the private sector gained a foothold in the microfinance sector in South Africa. However, until 1992, the former were the most important actors and they largely focused on the financing of entrepreneurs. In 1992 the government changed the Usury Act, removing the interest rate ceiling on loans under R6,000 (with a few additional rules). This brought a range of players into the market. In the early years, these were mostly small operators, which provided cash loans (or pay day loans) to low income South Africans. These players were quickly followed by term-loan providers, who provide loans over 6 to 36 months. In the beginning, this was a market where few rules applied. Although it opened access to financial services for many South Africans, it also opened up opportunities for exploitation and many low-income earners fell victim to unscrupulous practices.

In 1999, the government reacted by creating the Microfinance Regulatory Council. The ceiling was also lifted to R10,000. The MFRC's task, in essence, is to establish integrity in the market. In the same period, the market started consolidating, several commercial banks entered the scene and specialised microfinance commercial banks were established. Most of the conventional commercial banks created arms-length relationships with their micro-lender subsidiaries or partners. Micro-lending became a sizable sector and touched the lives of many people. In table 1, an indication of client groups (according to living standard measurement categories[3]) is provided. It is clear from the table that in almost all the lower income categories, access to conventional commercial bank accounts declined between 1998 and 2000. Note that the percentages in columns four and five measures access to formal-sector commercial bank accounts.

Table 1: Some salient features of Living Standard Measurement Categories in South Africa

LSM	Number of individuals aged 16 to 64 years	Average annual household income in Rand	Any bank account	Any bank account
	1998	2000	1998	2000
1	2,808,000	R 8,952	0%	3%
2	2,621,000	R 10,428	16%	11%
3	3,208,000	R 12,432	18%	17%
4	3,147,000	R 17,628	30%	29%
5	3,831,000	R 25,344	34%	43%
6	3,572,000	R 42,792	44%	62%
7	3,274,000	R 87,540	74%	78%
8	3,259,000	R 157,308	94%	98%

Source: IGI Consumer Scope, 2000.

[2] ABSA, Focusing Article, Is the South African Banking Sector still Sound?

[3] Living Standard Measurement categories are defined and used by the market research firms in South Africa. They describe the market and market profile for different income classes.

In table 2, outreach of retail financial institutions focused on the low-income market is indicated. It is clear from this data, that institutions have a sizable outreach. The data in table 2 covers all financial institutions interacting with the poor.

Table 2: Outreach of retail finance for the poor and low-income groups in South Africa

Retail Institutions	Loans R million	Savings R million	Number of Outlets	Number of Loan Accounts	Number of Savings Accounts
Public Sector	205	1,774	2,434	63,028	2,650,000
Private Sector	14,259	4,703	9,427	4,497,766	4,711,114
Informal sector	400	1,760	1,150,000	Not available	14,750,000
Total	14,864	8,237	1,161,861	4,560,794	22,111,114

Source: Coetzee and Grant, 2000.

It is clear from table 2 that the private sector in South Africa plays the biggest role in terms of the provision of financial services to the poor. Many of these private sector institutions are listed on the Johannesburg Stock Exchange and the bulk of outreach is from registered commercial banks.[4] However, the biggest component of private-sector outreach, when supply-side of financial products and focus is analysed, takes the form of consumer finance. Further estimates, based on the results of a range of sample surveys, indicate that there may be a considerable leakage of consumer finance into entrepreneurial finance. Table 3 provides some estimates in this regard. Note that this table represents an estimate of one-way leakage, from consumer finance to entrepreneurial finance. It gives no indication of the possible leakage from entrepreneurial finance to consumer finance. The number of outlets indicated in the table is a mechanistic estimate, based on the information in table 2.

Table 3: Outstanding loans and estimates of loan allocation for enterprise finance

Loans mostly for	Loans R million	Outlets	Loan accounts
Enterprise finance (from enterprise finance MFIs)	343	119	163,069
Leakage at 4 % from consumer lenders	565	373	175,909
Leakage at 10 % from consumer lenders	1,412	933	439,773
Leakage at 20 % from consumer lenders	2,824	1,866	879,545

Source: Coetzee and Grant, 2000

If the leakage from consumer finance loans to enterprise finance is estimated to be 10 percent, outreach increases from approximately 163,069 loan accounts to 439,773 loan accounts.

It is clear from this data, that the industry has increased in size, has formalised and has improved its integrity in recent years. It is estimated that there are more than 1,300 microfinance institutions in South Africa. These firms make use of more than 9,000 outlets to reach their clients (MFRC, Annual Report, 2001). These figures suggest that the microfinance industry is able to support the employment of approximately 30,000 people.

3. The model

3.1 Introduction

Microfinance can broadly be defined as the provision of financial services to low-income clients.[5] Although microfinance was closely identified as being in the development field in the early 1980s, positive results achieved by pioneering institutions transformed the perception of microfinance from a non-profit development-related business to a business with acceptable profit potential.[6]

[4] Note that the latest information from the MFRC indicates that registered banks have the biggest presence in the market, supplying up to 80% of advances (measured in Rand).

[5] Ledgerwood, J. 1998. Microfinance Handbook, an Institutional and Financial Perspective: Sustainable Banking with the Poor. December 1998. World Bank, DC.

[6] Rhyne, E. and Christen R.P. Microfinance Enters the Marketplace.

In South Africa this transformation has also taken place, as more formal commercial banks have entered the microfinance business, with profit being the motivation for participation.

Capitec defines its business as being in the microfinance field. For its holding company, however, microfinance is an entry point into retail banking, and the current range of products is only the beginning of what is foreseen to become a more comprehensive range of products in a niche market.

Institutionally, Van Greuning et al (1998) classified MFIs[7] into the following seven categories: Basic Non-Profit NGOs; Non-Profit NGOs with Limited Deposit–Taking; NGOs transformed into Incorporated MFIs; Credit Unions; Specialised Banks or Limited Deposit-Taking Institutions; Licensed Mutual Ownership Banks; and Licensed Equity Banks.

The Capitec Model clearly falls into the Licensed Equity Bank category, because Capitec has a very specific niche target market i.e. low-income formally employed individuals. For the purpose of this analysis, the Capitec model will be described as a Corporate Niche-Market Model.

3.2 Organisation origin and history

Capitec is a subsidiary of PSG Financial Services, of which the ultimate holding company is the PSG Group Limited, which is listed on the JSE. The current capital base of R391 million is mainly attributed to the involvement of the PSG Group Limited.

The microfinance business has been identified by PSG and a number of South African business people, based in Stellenbosch in the Western Cape, as a viable sector of the financial services market. This deduction is based on the existence of a large number of viable smaller microfinance institutions[8] and the inability of major commercial banks to meet the needs of the market.

The PSG Group Limited ("PSG") entered the low-income lending market in 1998 through the acquisition of two micro-lending branches in central Johannesburg, which had a book to the value of less than R1 million. At this time, a new venture, aimed at the payroll-deductions market ("Anchorfin"), was set up. A holding company, later renamed Keynes Rational Limited (Keynes Rational) was established to manage the venture.

By October 1998, the decision had been made to expand aggressively into the short-term loans sector. Accordingly, Finaid Financial Services (Pty) Ltd, with a book to the value of R13 million per month and 56 branches, was acquired. The existing business by then had 12 branches and Anchorfin had 700 active agents.

When growth in the Company flattened early in 1999, a new strategy of expansion through acquisitions emerged. However, concerns over the exposure to payroll deductions of government employees, led to the disposal of Anchorfin.

Acquisitions 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. On the operational side, the number of employees increased from 50 to 1,301 by 28 February 2001.

During the 2001 financial year, the strategic direction of Keynes Rational narrowed in focus to banking services, but broadened in scope of service provision. Accordingly a decision was made to focus solely on servicing clients in the lower income sector of the South and Southern African market. This service would be aimed at providing individuals and small businesses with a range of banking facilities, which

---

[7] Van Greuning, H., Gallardo, J. and Randhawa, B. 1998. A Framework For Regulating Microfinance Institutions. The World Bank: Financial Sector Development Department, December.

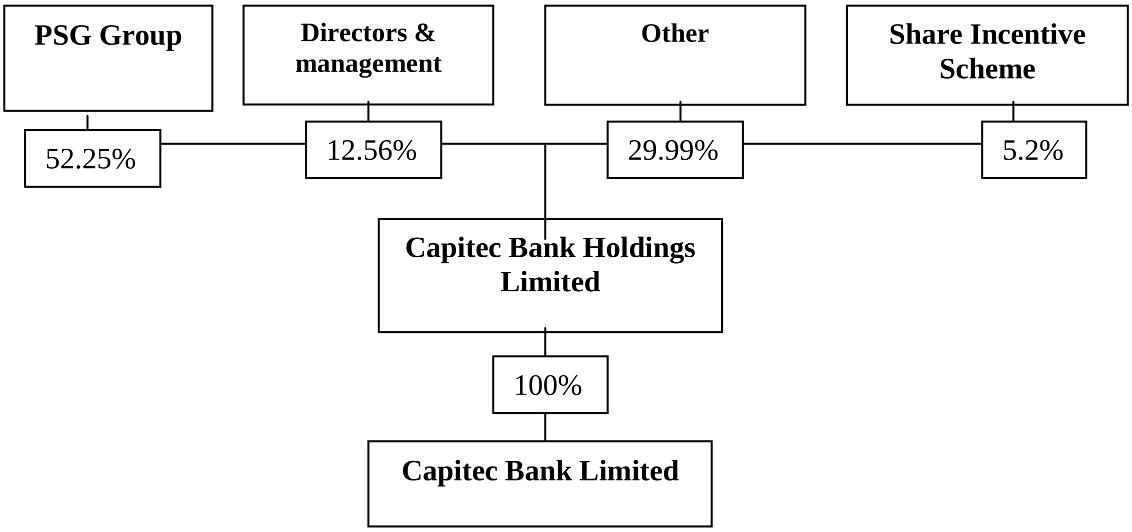
8 The decision to enter into the microfinance market was therefore based on the success achieved by existing micro-lenders.

are economical and affordable and are based on individual risk profiles, taking cash flow and ability-to-pay-models of risk evaluation into consideration.

In order to accomplish this, the need to apply for and acquire a banking licence and to increase share capital, became a necessity and priority. This lead to the restructuring and incorporation of the business of Keynes Rational into The Business Bank Limited (TBB) on 1 March 2001. TBB was a subsidiary of PSG Investment Bank Holdings Limited (PSGIBH)*. The name of TBB has subsequently been changed to Capitec Bank Limited. Keynes Rational was renamed Capitec Bank Holdings Limited in February 2002. The company was listed on the JSE on 18 February 2002.

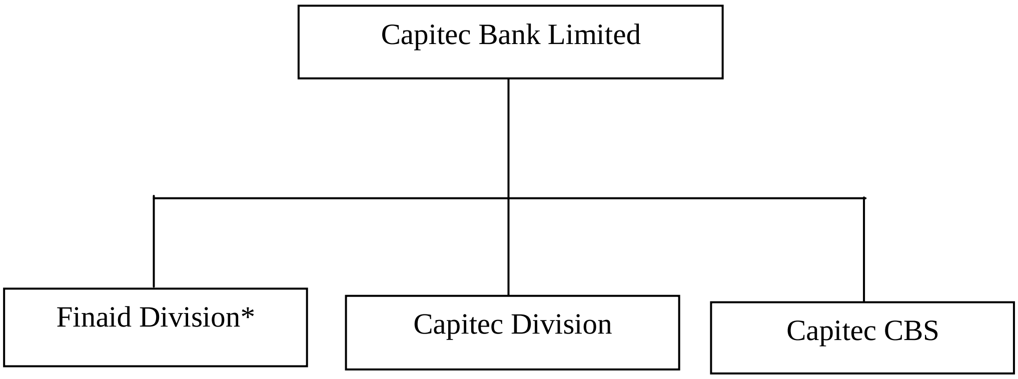
3.3 Capitec Bank Holdings Limited Structure (July 2002)

The group and ownership structure of Capitec can be summarised as follows:



3.3.1 Capitec Bank Divisions

The diagram below shows the various divisions that form part of Capitec Bank.



Capitec Bank Limited has three divisions. Two of these divisions, Finaid and Capitec, have now been combined in the near future. The Finaid division, for which a separate legal entity is registered, also operates in Namibia, where its operations have subsequently been sold.

3.4 Nature of the Business

Capitec Bank and its subsidiaries operate as specialist financial-service providers to the lower-income, historically “under-banked” sector. Capitec Bank’s vision is to develop into a fully-fledged retail bank for the “under-banked”, through a network of branches, in South Africa and neighbouring countries, as well as through a large number of access points, formalised using strategic alliances.

As a registered bank, Capitec Bank provides 30-day micro-loans to the lower-income sector through its operating divisions, Capitec and Finaid, as well as providing commercial loans to entrepreneurs through its Capitec CBS division. In addition, Capitec Bank has started a pilot project, which provides savings facilities to its target market through its Capitec division. The three-month loan product is available in approximately 44 Capitec branches. Interbank transacting capacity using a debit card is also being piloted. The activities of Capitec Bank’s operating divisions are set out below.

3.4.1 Finaid Division

Finaid focuses on providing short-term micro-loans to approximately 100,000 individual clients who fall into the LSM3 to LSM5 income-earning profiles (refer to table 1 for an explanation of LSM categories). These individuals may have bank savings accounts but are unable to obtain traditional bank loan finance. The term of loans granted is 30 days, and the amounts vary up to R10,000, seldom exceeding R2,500, with an average of R600. Interest rates vary, depending on the branch history, but are typically set at between 21.5 and 30 percent per month. Distribution of the product occurs through a network of 262 branches. The success achieved with Capitec branches, led to a recent decision to change all Finaid branches to the Capitec brand and do away with the Finaid brand. This has left Capitec Bank with only two divisions, Capitec (banking services) and Capitec CBS.[9]

3.4.2 Capitec Division

Capitec focuses on providing financing through a more structured environment to the higher income target market falling into the LSM4 to LSM7 income-earning profiles. The current business differs very little from that of Finaid. Capitec Division currently has approximately 20,000 clients. Although Capitec will continue to source walk-in clients through its distribution network in future, the main source of clients will be through group-based agreements, for example, with employers or trade unions.

[9] The transformation process is taking place in tandem and allows careful monitoring of business impact.

Capitec Division is in the process of setting banking systems into place, which allows the division to operate as a deposit-taking and lending operation with a card issuing facilities distributed throughout 55 carefully selected outlets in the bigger metropolitan areas of South Africa. These outlets all have a Capitec ATMs and branches have an open, modern appearance. With the conversion of Finaid branches into Capitec branches, new services are planned for the whole network of branches.

3.4.3 Capitec CBS Division

Capitec CBS focuses on providing commercial, unsecured loans on the "load-over-load"[10] concept to SMMEs in the informal market place. The "load-over-load" size is determined based on a specific business's acquisition profile through its traditional supply chain. As a spin-off, the commercial market is addressed through the Capitec retail distribution infrastructure by using the branch infrastructure as a transaction platform. The methodology applied in this division is derived from the experience of the founders of Capitec in retail trade.

3.5 Operational Process

In the process described above the company has:

- Integrated 275 cash-lending stores into a corporate whole at Finaid;
- Re-branded 260 of them to the Finaid Brand;
- Merged 27 branches;
- Found new premises for 32 branches;
- Introduced a unified administrative system;
- Trained all staff;
- Developed a new IT system and infrastructure; and
- Made 537 new appointments throughout the group.

In providing for a broader range of financial services, that includes savings, the company established Capitec as a brand. For this purpose it was required to design a new bank layout and open 55 Capitec branches.

3.6 Market and attributes

The formal banking sector and specifically the 'four big banks'[11] in South Africa are not considered by Capitec as direct competition, because they are perceived not to offer microfinance clients the products they need at a price, or in a manner, that makes them accessible to the target market. The main areas of concern, with regard to the approach used by formal banks, are as follows:

- They offer world-class banking to a broad spectrum of clients in the country, which includes credit cards and cheque accounts, foreign exchange and corporate banking, asset management and insurance products. They are, however, reducing their "real" presence and increasing their "virtual" presence by expanding call-centres and Internet banking;
- They have huge and complicated IT systems which are difficult to amend or adjust to provide non-standard, programme specific requirements;
- In line with international best practice, they are reducing overheads by identifying the cost of every product and transaction and setting prices for these products and transactions; and
- They do not consider individuals with small, infrequently-used accounts as lucrative clients.

3.6.1 Attributes

Claims have been made that cracks are appearing in an inherently sound banking system in South Africa. This has reduced confidence in small banks. The bad debt debacle that overwhelmed two banks early in

[10] "Load-over-load" refers to a continued cycle of loans for the acquisition of stock on the repayment of the preceding loan.
11 Amalgamated Banks of South Africa (ABSA), First National Bank (FNB), Standard Bank and Nedbank.

2002 and the run which took place on a third bank in March 2002, have cast a shadow over South Africa's banking sector, especially over A2 (smaller, niche-type) banks. The partial take-over of one of the failed banks by one of the big four commercial banks (First Rand) and the take-over of another smaller bank by Nedcor (also one of the big four banks) have had a profound effect on the banking system, having ushered in a new phase of consolidation in South African banking. This consolidation process is being furnished with a new impetus by the decisions of certain small banks to cancel their banking licenses as mentioned earlier.

A first priority for Capitec was therefore to establish itself as a viable micro-lender with an acceptable client base. For this reason the company identified four major pillars on which to build its business and to make it different to other micro-lenders. Capitec identifies its clients as the factory worker and the cashier at the local shop. The main attributes of its services are thus defined as follows:

Accessibility

Branches are positioned in areas that are accessible, with many at, or near to, railway stations or taxi ranks. Branch office hours are uncharacteristically long, from 08:00 in the morning to 17:30 in the afternoon, to cater for the working day of clients. In some instances branches stay open even longer where it suits clients. Branches even have the ability to go to the factories where their clients work.

With many of their clients dependent on public transport, accessibility is a major factor and discussions with clients have confirmed the value of this attribute. At one branch visited, specific arrangements were made with a group of factory workers in a nearby factory for services at a specified time-slot at the end of the month. This not only makes the services of Capitec more accessible, but also gives acknowledgement to the client in appreciation of their business.

Affordability

At R1.80 per transaction Capitec offers the lowest ATM (Automatic Transmission Machine) fee in the country. The minimum opening balance requirement on savings accounts is only R10. This R10 is only an opening fee, and can be withdrawn soon after the account has been opened. There is no permanent minimum balance on savings accounts.

In focus group discussions with clients, most did not list affordability as the highest product attribute but did express appreciation for the low cost-structure. Staff, however, believe that low cost is a major attribute, specifically for marketing purposes. Low cost is thus used extensively in marketing the services of Capitec. Affordability is therefore more important for convincing clients to join Capitec, after which access to money and good customer service become the highest priorities.

In South Africa, financial service costs are driven up by high levels of crime and violence. Capitec has not been immune to this in the past, having had armed robberies at branches. By implementing a card-based system, where minimal amounts of cash are kept at branches, Capitec is able to reduce risk of robbery, which in turn brings down costs related to crime.

Simplicity

The current range of products is limited to micro-loans, savings and debit cards (Maestro[12]/ MasterCard linked). A simplistic transaction methodology, requiring limited paper flow, has been developed for these products. Branch operations have been developed so that they are completely paperless, and clients are not required to fill in slips of paper to do transactions. All transactions are card-based and transactions that are not done directly on computer, are scanned onto the IT system.

[12] Debit card

During focus group discussions, some clients expressed a need for a broader range of services including longer-term loans and transmission facilities. These services are in the process of development. The simplicity of the system contributes to faster service and gives local staff more time to interact with clients, which allows them to give advice to clients. For most clients advice is a high priority and they appreciate the fact that Capitec's service structure allows for this. Although operation of ATMs can be complicated for illiterate clients, it has proven to be successful thus far, because technology used has been adjusted so that ATM screens are suited to the needs and preferences of Capitec's target clients.

Face-To-Face Service

The majority of microfinance institutions, which were acquired by Capitec, were managed by their owners. This meant that clients became used to personal services and quick response time. Capitec places a high premium on face-to-face service with easy access for every client to a consultant, who endeavours to speak the native language of the client. Most clients expressed great appreciation for the personal attention they receive and they value the financial advice given by consultants. Personal attention is becoming quite rare in South Africa, especially in the formal banking sector. Face-to-face transactions are normally only used for loan application and approval, whereas cash transactions are done by the clients themselves at ATMs. Staff, do not handle cash on the disbursement side of transactions. This in turn decreases the risk of robberies at branches.

3.7 Product range

Various Capitec products, both fully implemented and some in the pilot stage of implementation, have been mentioned thus far. These products are described below in more detail.

3.7.1 Short-term loans

Loan conditions

- Period – One month.
- Interest rate – Initially all branches charged 30 percent per month. Most Finaid branches are now charging 21.5 percent per month. Most Capitec branches now charge 18.5 percent per month (this is intended to become the standard for all 30 day loans). Lowering of interest rates has increased branch portfolios, confirming that clients are sensitive to pricing levels.
- Repayment - One instalment at the end of the month is the normal repayment pattern, however, in some cases four weekly instalments are accepted, in line with clients' salary payment schedules.

Qualifying criteria

- Proof of employment.
- An account with one of the main commercial banks so as to enable payment requests directly from the account where the client's salary is paid in.
- Loan value is based on 50 percent of net income.
- Credit Bureau enquiry on other loan responsibilities.

Administrative procedures

The new system has been developed in a manner that reduces administration at branch level to a minimum. Although still in the process of implementation and rollout, the system shows tremendous potential. It can be summarised as follows:

- Live data capturing by the loan officer during application screening, which includes an image of the client, and the required documentation.
- On conclusion, a loan contract and debit card is produced allowing immediate transmission of the loan amount.
- Centralised administration of the system at Head Office.
- Centralised auditing.
- Centralised data interlinking with the financial system and MIS (Management Information Systems).

Loan disbursement method
In most Finaid branches, disbursement of loans is currently cash-based. The model developed for Capitec includes a Maestro debit card into which the loan value is transmitted, allowing clients to draw either at Capitec ATMs or any other Master Card service provider, or even use the card for transactions at participating retailers.

Repayment method
Although a small number of borrowers repay in cash, the standard procedure is for Capitec to submit a withdrawal claim on the date of the client's salary payment, against the account with the bank where the client holds an account (no card and PIN system is used by Capitec). The fact that cards and PINs are not kept is well received by clients.

Other
No administration fees are charged on loans.

Portfolio

Number of clients:	±200 000
Total advances outstanding at year-end:	R118.105 million

3.7.2 Savings accounts
Capitec Bank has only started with savings products in a pilot project. Although the project is still in an experimental phase, it forms an integral part of the long-term goals of Capitec.

Basic attributes
- Interest rate is 7 percent per annum regardless of balance.
- Card based.
- No administration fee.
- Withdrawal fee at Capitec ATM's R1.80.
- Normal withdrawal fee at other service providers.
- No minimum balance other than a R10.00 balance when opening the account.
- Individual and group target.

3.7.3 Capitec CBS loan products and related services
Capitec CBS has identified a need in the wholesale market for services to spaza[13] shops, and thus developed the "load-over-load" product to cater for this market. The product consists of the following three elements:

Wholesale service to spaza shops
Catering for the typical product range of spaza shops, the company (a fast-moving consumer goods merchandiser) procures goods in bulk through a centralised warehouse. Although centralised systems such as this do exist, transport and finance still tend to be a problem for SMMEs. CBS provides the following services:

Bridging finance
A bridging finance facility for financing stock for spaza shops is offered to all clients at 3 percent interest per week. The average loan size is R3,000. Repayments are made on a weekly basis. Approximately 1,000 clients are already making use of the facility.

[13] Home-based retail businesses, mainly in consumer goods, are referred to as Spaza Shops

Delivery service
Private couriers have been contracted by the merchandiser to deliver goods directly to clients' houses and shops. The cost of this service is paid directly by clients. The delivery services are also essentially small businesses which have been financed through Capitec CBS. They have the advantage of receiving an almost constant stream of work from the warehouse to the spaza shops on a contract basis. This service is closely monitored by Capitec CBS to ensure that there are not too many or too few delivery businesses.

3.8 Ownership, Governance and Management

3.8.1 Group ownership

The PSG Group provides the main capital base for the company, but due to substantial shares in the company held by directors and management, real operational ownership and acceptance of responsibility is obtained. The relatively cautious approach followed with the introduction of a new brand name, with the changes in interest rates and with the establishment of a strong corporate image, all reflect a great deal of care and responsibility shown by the directors and management. Superior profitability and high client coverage are inherent to the objectives of Capitec, confirming the importance of both social responsibility and the profitability as part of its mission.[14]

3.8.2 Operational Management

The operational aspect of Capitec Bank is headed by a Chief Executive Officer, who is supported by a Managing Director. The latter, is in turn supported by the Chief Executive for Sales, Chief Executive for Business Development, Operations Managers and Chief Executive for Capitec CBS. Four Operations Managers responsible for various geographical areas throughout South Africa, as well as Namibia, report to the Managing Director for their areas. Each of these Operations Managers has a team of Regional Managers as subordinates. These Operations Managers are each responsible for eight to ten branches. Each branch is headed by a Branch Manager who is typically a Sales Consultant who has been with the branch for some time, or has experience in micro-lending.

This integrated operational system allows Capitec to maintain a very flat management structure with the emphasis at regional manager level. The total staff complement at present is 1,213.

Acknowledging that the company is in its strategic development phase, the operational management structure reflects the emphasis and attention to sales and business development. The emphasis placed on sales and direct marketing by field staff during off-peak periods has really paid off. Field staff has confirmed the positive effect of personal marketing.

The executive management team has substantial experience in the retail and banking businesses and provides strategic management and direction for the business. The challenges faced during Capitec's establishment, reached all aspects of the business. Management's achievements and level of expertise, reflect a clear vision in their selection and appointment of staff.

Operationally, the four pillars mentioned above form the core base of the business. The Product Range, Human Resources and MIS Systems have all been developed around the core base. The functionality of these systems can be considered one of the most important management achievements.

[14] Rock, R., Otero, M. and Saltzman, S. 1998. Principles and Practices of Microfinance Governance. ACCION International: August 1998.

3.8.3 Staff transformation

Capitec followed an approach of obtaining a branch network by purchasing viable independent micro-lending businesses and their staff. They were confronted with a number of expected, but also unexpected, human resource challenges. This includes aspects such as:

- Lack of capacity – Operations centred on the owners who were directly involved in almost all operational aspects of the business. Decisions were taken based on intimate knowledge of clients, while staff had very little exposure to decision-making.
- Variety of systems and procedures – Each micro-lender had its own systems, which were primarily based on personal taste and exposure.
- Small money-lender/loan shark culture – In most cases micro-lenders are associated with the typical money-lender/loan shark culture. This culture had to be changed into a corporate formal market culture.
- Close staff-client relationships – Staff perceived clients to be theirs, and not Capitec's. This culture had to be changed to reflect a corporate image, where clients became Capitec's.

The main task was therefore to transform and establish a workforce that provides for the requirements of the company. Most of the staff had had very little training in the past and were therefore very responsive to training programmes. It was possible to follow a philosophy of education, not just teaching. Staff was able to benefit from all-round experience, in that training courses were supplemented by technical on-the-job experience and refresher courses.

The nature and extent of change from small independent micro-lending operations to a corporate structure required the incorporation of change management into the training programs. This ensured staff buy-in into the transformation ideas of Capitec and the establishment of a corporate banking culture with a shared vision. This transformation has been carried out very successfully.

Management style is presently quite strict and disciplined, in support of the establishment of the corporate culture and image. Management at supervisory level requires significant training, due to the fact that managers lack experience and need to be empowered. Most senior staff members were promoted to branch management positions, even though they did not necessarily have previous management experience in the independent money-lending business. A performance evaluation tool has been developed and implemented in all branches. This tool measures:

- Output growth in comparison with daily, monthly and yearly targets;
- Client growth in comparison with daily, monthly and yearly targets;
- Default repayments in comparison with company targets; and
- Branch cost and profitability measured against targets.

In the present phase of the transformation process, training focuses on technical and transformational issues. In the future more focus is planned on teamwork, motivation and the softer side of staff performance.

An incentive remuneration scheme, which links performance to basic salaries, has been introduced. In addition, non-monetary incentives such as employee-of-the-month and inter-branch competitions have also been introduced. These schemes strengthen the corporate culture of the organisation. This caring culture is further strengthened by providing support and counselling to staff affected by robberies, as well as training on handling robberies.

Staff benefits include group-life and retirement provision, however no medical-aid scheme exists at this stage. A high premium is placed on internal communication, which has been greatly improved by means of the monthly newsletter, Imbizo, which means a community gathering, called by the chief, normally for the purpose of sharing news. Imbizo is used to communicate where Capitec is in the transformation process. It also discusses problem areas, communicates who the achievers are in the various branches, which branches are doing well and personal news such as staff marriages, etc. The monthly newspaper is very popular amongst staff and is publicly displayed at most branches.

Staff is generally sourced from retail businesses such as Woolworths and Pick 'n Pay, since employees from these businesses have sales experience and are more focused on client service.

3.8.4 Management and Governance

The company explicitly acknowledges the value of enthusiastic and dedicated employees. It is for this reason that the necessary incentives in the form of shares in Capitec Bank Holdings are provided. The company subscribes fully to the principle of efficient corporate governance. To this end it continues to strive for achieving and maintaining levels of corporate self-regulation and control, which create an ambience of efficiency and trust. In order to implement corporate self-regulation and control, the company has accepted and subscribes to the following aims:

- Control over the company rests fully with the board of directors. To enable it to exercise its function properly, strong emphasis is placed on presentation of timely, good-quality information to the board.
- The composition of the board is such that non-executive directors are in the majority. Individuals are elected and assessed on the strength of recognised skills and their potential to make a meaningful contribution on an ongoing basis to the well-being of the company.
- Technical advice is sought from the best available sources in appropriate circumstances. A high premium is placed on obtaining the best advice.

Chairman

The Chairman of Capitec Bank holding and Capitec Bank is also the Chairman of PSG Group Limited. This ensures a direct communication line between Capitec and its majority shareholder. The knowledge and appreciation shown for the microfinance business reflects a comprehensive understanding of the opportunities and risk of the business. This, together with the willingness to invest in Capitec, clearly indicates trust in the business and its handpicked management team.

Non-Executive Directors

Non-executive members of the board are expected to assess strategy, performance, resources and codes of conduct independently and rigorously. Individual members must maintain quality contributions to the procedures and resolutions of the board. For this reason, re-election is not a certainty.

Board Appointments

Board appointments remain the responsibility of the full board, which acts on the recommendations of a nomination committee. New appointees have to acquaint themselves with the business of the company and are afforded full support in this regard.

Remuneration of Directors and Senior Management

An independently functioning committee, chaired by a consultant expert, determines the remuneration of directors and senior management. The disclosure of directors' remuneration is done in compliance with statutory requirements.

Board Meetings

The board meets ten times per year. Emphasis is placed on timely presentation to the members of comprehensive, quality information, so that they can assess the performance of the company fully.

Company Secretarial and Professional Advice

All board members have access to the company's secretarial department for advice and information, which is obtained internally and externally.

Communication with Stakeholders
Emphasis is placed on regularly communicating with stakeholders in an open and frank manner, emphasising substance rather than form. Positive as well as negative aspects of the activities of the company, inclusive of non-financial matters, are addressed with an emphasis on transparency and completeness.

Audit and Audit Committee
An internal audit function is maintained and structured in accordance with the needs of the business. This function encompasses the entire spectrum from short-term loans to sophisticated information technology based banking systems infrastructure. Partial outsourcing is utilised to ensure that the best technical skills are available.

An independent audit committee reporting directly to the board, and constituted in accordance with regulatory requirements, oversees the financial and systems risk areas of the company. The Audit Committee is comprised of a majority of the non-executive directors under chairmanship of an independent chairperson. The committee meets at least four times per year with external and internal auditors, senior management and central bank regulators. It reviews accounting, auditing, financial reporting, internal control and matters of internal and external risk.

Ethical Code
The board and management subscribe to and enforce high ethical principles of conduct and business operation throughout the organisation. The Bank also supports and subscribes to the Code of Good Banking Practice.

The Bank has an extensive infrastructure of committees addressing various components of risk management. These committees have as members a wide array of non-executive directors, senior management and external as well as internal auditors. The relevant committees are:
- Remuneration Committee;
- Risk Committee;
- Asset and Liability Committee; and
- Executive Management Committee.

3.9 Administrative and Operating Systems
In a small micro-lending business the administrative systems and procedures are very simple due to direct involvement of the owner/s in the business. The decision-making process is also very quick because in most cases the owner/s makes decisions on the spot. This is an attribute which clients find appealing, because they have quicker access to cash.

One of the major initial challenges facing the company was, therefore to replicate the simplicity and quick response time to which clients had become accustomed. These positive attributes now need to take place in an environment with a corporate image, corporate culture and common vision.

3.9.1 New system
To achieve the set goals, the organisation decided to develop a comprehensive IT (Information Technology) and MIS system that would accommodate its needs. The ultimate goal of the advanced technology was to minimise additional administrative tasks throughout the system, while still providing the client with person-to-person interaction. The loan application process was defined to include the following steps subsequent to credit evaluation and approval:
- Scan Identity Document and check it using barcode;
- Scan pay slip;
- Take photo of client;
- Capture additional required data;

- Open account;
- Print loan agreement;
- Allow client to sign the agreement, then scan it, returning the original;
- Create an ATM card; and
- Give the card to the client.

Catering for the above, as well as operational requirements, the system was designed taking the following requirements into account:

- One-stop service with one consultant;
- Centralised controls;
- Minimal administration;
- Simplicity;
- Minimal paper work for consultants;
- Minimum paper for clients;
- Centralised credit and audit control;
- Card-based system;
- Fraud prevention and tracing;
- Transaction control through fingerprint biometrics; and
- Photo image and ID scanning.

It is clear that turnaround time is short, except where clients cannot provide all information, and that most of the administration is computerised.

3.9.2 Operational status of new system

The development and implementation of the operational system is at an advanced stage, with minor problems in image scanning resulting in time delays when processing transactions. These problems are particularly prevalent during peak periods, causing unnecessary delays in completing transactions. The MIS system is still in the evaluation and implementation phase with weekly information downloads from the system. The final goal for the MIS, is regular management reports for different levels of management. Completion of the MIS is currently a high priority. Live integration of the MIS system with branches is also planned in support of operational efficiency at branch level, specifically aimed at reducing administrative functions.

4. Performance analysis

4.1 Outreach Breadth and Depth

At inception it was decided that the company would be a regional/national service provider. With this aim, the company bought viable micro-lending businesses in all provinces of South Africa as well as four in Botswana and 12 in Namibia.

The target market of Capitec is individuals who are formally employed and in need of short-term micro-loans. The company's current market share in the short-term micro-loan market is roughly 15 percent. The aim is to grow market share over the long-term. Although the initial establishment phase, which was achieved through the acquisition of viable micro-lenders, was rapid, future growth is planned more conservatively at a rate of 20 percent per year.

Capitec has opted for an integrated electronic model, which makes outreach and growth dependent on effective electronic communication. The current branch network as set out below services Capitec's existing clients in South Africa.

Region	Number of Branches
Western Cape	57
Northern Cape	11
Eastern Cape	35
Free State	14
Gauteng	70
Northwest	19
Limpopo Province	18
Mpumalanga	22
KwaZula/Natal	53
Total	**299**

4.2 Financial performance

The decision to transform Capitec's operations to those of a bank was strategically directed at a broader range of financial services including deposit-taking and transfers. This is a huge undertaking, the impact of which includes:

- Training of hundreds of employees to work with the new system;
- Transformation of all Finaid branches into fully fledged Capitec branches;
- Provision for electronic funds transfer services at a fixed annual cost;
- Permanent linkage of all branches and ATMs with fixed lines;
- Links with all other commercial banks in South Africa; and
- Launching a national marketing campaign.

The Company started with a reduction of its interest rates from 30 percent per month to 21.5 percent in most of the Finaid branches and 18.5 percent in the Capitec branches. Despite these reductions, interest received on loan advances increased by 33 percent, reflecting a substantial increase in the loan portfolio. The risk profile has been maintained at acceptable levels, however, with reduced interest rates Capitec requires substantial portfolio growth to maintain profitability.

In R million	2002	2001	Change	%
Interest on loans and advances	266,923	201,327	65,596	33%
Operating expenses	(178,333)	(129,447)	(48,886)	38%
Net bad debts	(25,896)	(14,339)	(11,557)	81%
Depreciation on fixed assets	10,845	3,476	7,369	212%
Operating lease rentals	26,122	14,065	12,057	86%
Office equipment	2,272	1,428	844	59%
Salaries and Wages	66,685	50,928	15,757	31%

Notes:

- Operating expenses increased by 38 percent, of which salaries and wages were the major contributor. The increase relates to the bigger branch network established during the past year.
- Operating lease rentals increased by 86 percent reflecting the impact of the extended branch network but more prominently, reflecting relocations.
- Increased depreciation reflects substantial investment in systems and equipment.

Capitec invested R109.5 million mainly in IT systems and new branches. This investment, of course, is capital and most of it will only start flowing through the income statement as depreciation in the coming financial year. A year-end profit of R29 million is projected for 2002/2003. This performance reflects a combination of growth and the cost implications of the full-banking platform.

4.2.1 Specific Risks

The following risk areas are the most important for Capitec:

Credit risk

Having originated from a purely lending operation, Capitec's entire operations staff is acutely aware of credit risk as the most visible of the present risks attached to business. Accordingly policies, which have been formulated to limit this risk, are enforced. These policies and procedures, enhanced in the Capitec Bank environment, are applied as follows:

- Uniform policies, approved by the credit committee, are formulated and then formally communicated;
- Policies and specific criteria pertaining to advances are strictly enforced;
- The quality of internal and external risks pertaining to the advances book, are constantly monitored and preventative measures applied wherever possible;
- The best available debt recovery methods are employed;
- The nature of Capitec's market lends itself to credit scoring, provided that sufficient data are available. To this end technological infrastructure has been developed to capture sufficient relevant data to allow for development of scoring models. Scoring models have centralised online links to selected credit bureaux.

Bad debts[15]and debt management

In theory, the main bad-debt risk is the risk that a client may lose his/her job. In practice the biggest problems arise as a result of administrative errors. For this reason administrative competence is seen as the key to debt management in this market. All cases where an amount is not received on the due date are followed up within 24 hours, because all clients can be reached telephonically.

The policy for provisions and write-offs is as follows:

- If any payment is not received on the due date, that loan is regarded as being in arrears;
- If payment has not been received within six months, the loan is written off as a bad debt;
- A provision based on Capitec's actual write-offs is made against all loans; and
- The provision percentage for all outstanding loans is changed immediately when a change in actual write-offs occurs.

Capital adequacy

The South African Reserve Bank specifically requires a capital adequacy ratio of 15 percent for Capitec. Compared with the accepted Basel standard of 8 percent and the ratio prescribed by the Registrar of Banks for the bigger commercial banks of 10 percent, Capitec's ratio reflects the risk profile of a niche market service provider. Capitec's policy is to maintain a sound and appropriate capital structure to provide for organic growth, expansion and acquisitions and to inspire investor confidence.

Interest rate risk

The interest rate risk emanating from lending margins, the re-pricing of assets and liabilities and the time periods during which these prevail, are measured and monitored by the asset and liability committee. For this purpose, maturity and re-pricing gap analyses are used.

Technological risk

Possible sources of technological risk are failures in systems support, including errors in the development of programmes, formulae of mathematical models, inadequate or untimely management information, failure in systems or network channels, breakdowns of physical and logical security and inadequate contingency planning. Information technology is central to the Bank's operations and competitive strategies. It provides tools for internal control and risk management, which are enhanced by unique customisation and configuration of the systems to address the target market. A major factor is to ensure

[15] The reduction in interest rate from 30 percent to 18.5 percent is impacting on the market and has attracted more clients to Capitec. This allows Capitec to be more selective with loan approvals and will further reduce risk.

that investment in information technology contributes to the Bank and adds value. Policies followed include:

- The board through the chief executive information technology, ensures that adequate and comprehensive business continuation plans have been established and tested, in order to address any disruption of normal business operations;
- New systems are subjected to adequate testing before implementation. Adequate backup and recovery procedures are implemented to ensure that the Bank can withstand failures of hardware, software and telecommunications within acceptable levels of disruption. Full contingency plans are in place in the event of failure;
- Computer system backup is done daily (refer to operational risk discussed below); and
- Disaster recovery of computer systems and operations, are monitored regularly to ensure that staff are aware and able to produce what is required in a crisis situation.

The Bank continuously assesses the adequacy of its information systems and makes provisions for the requisite upgrading thereof.

Operational risk

This risk manifests from breakdowns in the controls relating to unidentified limit excesses, fraudulent practices related to advancing of loans, money laundering, lack of controls surrounding processing of transactions and the recovery of loans. In addition, operational risk is the risk that business processes are not clearly defined or are poorly aligned with business strategies, do not satisfy client needs or expose significant assets to unacceptable losses, risk taking, misappropriation or abuse. The Bank minimises these risks through its:

- Systems of internal control;
- The establishment of a legal risk function;
- It is the Bank's policy to, as far as possible, have all systems fully computerised and integrated, so that the production of management and accounting reports has very little manual intervention. This reduces risk and increases the level of accuracy and timeliness of management reporting.
- The primary objective of management is to continuously identify possible weaknesses and to eliminate these.
- Management is assisted in the identification of weaknesses by regular internal and external audits. The internal audit function is partially outsourced.
- Quality of people and value systems engenders commitment, loyalty, integrity and ownership among employees.
- The level and nature of external insurance policies ensures that claims have no significant impact on the Bank's profitability.
- Operational policies of the Bank are adequately documented and communicated to personnel.
- Disaster recovery programmes for the computer systems as well as for operations are maintained regularly with staff involvement. This ensures that employees are fully aware of what is required in such a situation.
- Computer system backup is performed continuously.
- The computer systems are upgraded regularly to ensure that they cope with the Bank's expanding business and that no weaknesses develop due to systems being unable to handle new business and products.
- The present operational environment of the Bank is cash intensive. The information technology being developed at present will reduce the level of this risk by cash intensity through issuing of Maestro branded cards and by providing an ATM network at all branches.

Compliance risk

Management of regulatory risk, apart from being a statutory obligation, is one of Capitec's highest priorities. This risk is managed by a senior official in the Bank who reports to the chief executive for risk management. This senior official reports indirectly to the managing director. In addition, this individual has unrestricted access to the audit committee as well as the chairman of the board of directors.

Compliance risk comprises, in the first instance, the risk that stated in-house procedures to specifically ensure compliance within a regulated environment are not adhered to; secondly that the spirit and letter of the externally regulated environment is not upheld and thirdly that such non-compliance may negatively affect the public perception of the organisation.

To address this risk, the compliance officer, supported by adequate staff and other infrastructure, is seen to operate independently in assessing, reporting and correcting instances of non-compliance. Adequate channels of communication with line management have been set up, supported by proper reporting, to ensure that a compliance culture is nurtured through educating staff on a company wide basis.

Legal risk
This risk manifests in non-enforceability of contractual rights of the Bank or obligations of third parties to the Bank on a civil law basis. It may further arise on a criminal basis from non-compliance with statutes or from delict in wrongfully harming a third party. The risk is addressed by obtaining access to legal expertise through appointment of in-house legal advisors of suitable background, and further by training, applying and utilising third party skills on an outsourced basis to ensure that the best expertise in any particular field is accessed.

5. Achievements of and challenges facing the model

The model has been defined as a corporate niche market model. For the purpose of this study it is, however, important to review the approach taken in establishing the model. This was achieved by the identification of market potential based on the performance of existing small operators, identification of weaknesses in operational processes and identification of possible solutions to the weaknesses.

After making a business decision to enter into the market, the company obtained a sustainable portfolio through the selective buying of viable small micro-lenders. They further developed new systems and procedures to cater for their requirements and the implementation of their strategy including the recruitment, appointment and training of staff. It is clear that Capitec's strategy was aimed at consolidation of many different branches into one institution. This posed several challenges, including ensuring that the culture, systems and infrastructure of the different braches were congruent over time. During this process, Capitec gained tremendous experience in managing mergers, in integrating different institutional cultures to form a unified culture. Further experience was gained in retaining customers and staff and migrating disparate systems to a single standard. In essence the latter experiences are the main lessons emanating from the study, in addition to the lesson of formalisation. In the international microfinance literature this process can be equated to a process of up-scaling. Capitec's experience is, however, of quite a different nature to that, which the current wisdom in the sector reflects.

5.1 Achievements

In summary, Capitec has managed to maintain the overwhelming majority its clients throughout the conversion from 315 independent micro-lenders into a single corporate structure. In addition Capitec also expanded its portfolio during this establishment phase. This involved the development of new systems and procedures that comply with most of Capitec's operational requirements, while still providing clients with acceptable service. The consolidation process required the development and implementation of new systems, while simultaneously allowing for provision of a full compliment of services to clients. Many different strategies were tested. None of these strategies, however, migrated newly acquired branches onto the new system, without a complete conversion and parallel run with the existing system.

Recruitment and employment of 537 new staff has taken place. Extensive training of existing and new staff has been carried out. As part of this training Capitec also created a corporate image that is widely accepted by staff and clients. The biggest challenge was to ensure that new staff internalised the culture and rules of Capitec. One approach was to set strict but simple rules, for example, the rule that no loan repayment can be more than 50% of a client's net monthly income (after all other deductions).

A high quality customised Information Technology system was implemented during the transformation process. This IT system helped with the standardisation of the independent micro-lenders into one corporate structure. By the time the final design and adjustment process had commenced, all the different systems (from newly acquired businesses) were on board and staff could learn from these systems. In addition, the retail and banking backgrounds of most of the senior role players in Capitec served as a valuable resource in the design of the new system.

A large success factor for Capitec has been the 'four pillars'. Clients have easy *access* to service because of extended business hours and the positioning of branches on transport routes. This is extremely important as most other institutions serving the same market still follow the traditional branch placement and design approach, which is more convenient for the organisation than for the client. The placement of branches near transport nodes and other high-density areas has also brought security risks. This in turn contributed to the motivation to use a card-based system and to minimise the handling and disbursement of cash. In a way, Capitec branches were used as an experiment to design new products and delivery systems, while Finaid branches were used to ensure that business and cash flow continue.

Affordability has been achieved through sharp reductions in interest rates, minimal withdrawal fees and a minimal compulsory opening balance. The convenient placement of branches further contributes to affordability for clients as it has decreased client transaction costs. Capitec's loan system is vastly superior to cheaper loan systems where there are many non-interest costs heaped on clients, for example inconvenient placement of branches, inconvenient business hours and inconvenient systems and application procedures, etc.

Through the development of a user-friendly IT system and a card-based system for clients, *simplicity* is achieved for both clients and staff. Clients are also not overwhelmed by technology, as there is always a staff member on hand to assist. The use of a client photos contributes to making the system friendly, as clients are able to recognise their photos on the screen when they interact with the system.

Face-to-face service is very important at Capitec, especially due to the fact that acquired independent micro-lenders have a history of face-to-face service. Extensive service training with sales consultants has been carried out and clients receive good quality face- to-face service in all branches. Training also ensures that a consistent service quality is provided at all branches.

A successful branch network, with well-functioning systems and good quality service has been established during the transformation phase, while the company has managed to achieve positive financial results. The leadership of Capitec strives to keep abreast with trends, changes and innovations in the microfinance market in South Africa and internationally. It is quite common to see the MD of Capitec attending and speaking at conferences in South Africa and the region.

5.2 Challenges

- The process described above is in the final stages of completion, and is now reaching of the stage of consolidation. Institutionally the main challenges identified, include the successful establishment of a corporate image and the conversion of Finaid branches to Capitec branches.

- Operationally the main challenges identified include the finalisation and implementation of network and MIS development to an acceptable level, the establishment of a critical savings market and portfolio, and addressing the demand for a longer-term loan market. This also includes the expansion of business loans. Capitec has succeeded in developing an attractive business loan product for small traders, however, the challenge remains to expand the products offered in the broader SMME market.

The ultimate objective of any financial service provider is to obtain acceptable ratings as a financial service provider so as to attract more investment and obtain appropriate funding for growth.

- Capitec operates in a well-established microfinance market and as a corporate structure its operations will not only be acknowledged in the microfinance market but even more so in the formal financial sector. As one of the leaders in this market it must anticipate that the profitability of its operations will attract the attention of the existing formal market sector.

- Capitec's main challenge remains to achieve the trust of the market in the integrity of its operations and achievements. This will lead to shareholder confidence and recognition for its achievements. It must be noted that Capitec listed on the JSE shortly after two microfinance banks had failed. These failures gave investments in microfinance institutions a risky profile. Capitec had to ensure that this profile improved and that more investors were willing to invest.
-

6. Conclusions

6.1 Strengths and challenges

6.1.1 Strengths

Capitec's strength lies in strong backing by a healthy holding company and the ability for innovation based on the experience of a wide selection of stakeholders. These stakeholders are both the senior management of Capitec and the erstwhile owners of branches bought by Capitec. In most instances, these owners became part of the Capitec staff and thus their expertise was retained in the organisation. Some of the strengths that contributed to Capitec's success are highlighted below:

- The initiators of the model are experienced entrepreneurs, who took their cue from tested operational models in the trade environment.
- A strong capital base provided the required resources to implement the model, and critical mass was obtained through financial muscle. The presence of the PSG group made it possible for Capitec to finance the rapid expansion of the organisation. It also enabled financing of the requirements in terms of systems and training necessitated by an extreme growth curve.
- Through buying out existing micro-lenders the organisation had the ability to analyse the sustainability of various portfolios and to be selective in establishing a base portfolio. New MFIs starting from scratch have to establish a portfolio through trial and error. In many cases this is one of the biggest hurdles for MFIs to overcome, that is, growth of the portfolio, without lowering standards in terms of portfolio quality.
- The portfolios acquired by Capitec were in principle sustainable, providing a good base for consolidation and improvement.
- Taking over the existing staff, brought with it client and market knowledge obtained in a relatively competitive environment. However, it also brought with it different cultures and Capitec's ability to establish its culture in newly acquired branches, contributed to the building of core staff.
- The high-tech specialised approach followed still requires some reduction in the required time for implementation of the model. As Capitec is developing its own system and the mere fact that this system was made operational in a short period of time, shows that its investment in IT expertise was a prudent move. It must be noted that many small institutions would not be able to replicate some of the lessons from Capitec, merely because they lack both the capital strength and the expertise.
- The four business pillars, Simplicity, Accessibility, Affordability and Face-to-Face service, proved an excellent foundation for the business and reflect a clear understanding of the needs of the clients.
- Strong leadership and exceptional technical capability at senior management level.
- An operational staff comprised of young and enthusiastic people.

6.1.2 Challenges

Many challenges still remain for Capitec. The bank is still maturing and many of the initiatives taken, must still be consolidated.

- Hi-tech dependency impacts on outreach and excludes the rural market, because an ATM-based approach is reliant on the availability of electricity and telephone lines. It must be noted that this is only true for remote rural areas in South Africa, because small rural towns do have access to electricity and telephone services.
- Interest rate reduction allows lower risk selection, which increases the risk for competitors. Capitec improved its income during interest rate decreases, because clients reacted to the price changes and demanded more products. This implies that Capitec is operating in a market where competition is increasing and poses a formidable challenge.
- Microfinance market risk requires higher capital adequacy, which reduces the intermediation ability of Capitec. Strong financial backing by the group lightened this load, however, Capitec is still struggling to ensure that it is adequately capitilised.
- Staff focus group discussions showed a distinct difference between their training and their level of understanding. Conversion of Finaid branches to Capitec branches during the next phase of transformation will be a challenge for the Bank. Intensive training and change management will need to be focused on these branches during the transformation phase.

6.2 Lessons for Mainstream MFIs

- In an established microfinance market, use of the right approach does not require slow growth to be successful. It is, however, important that the four pillars be followed closely. These can be summarised as ensuring access and delivery of products that clients want, thus reacting to market preferences.

- This customer-focused approach is evident in all facets of the business, whether they be product design or design of MIS and IT system. The fact that unsophisticated clients are not swamped with technology and paper, reflects an understanding of the client profile and preferences. MFIs should take their cue from Capitec's intimate knowledge of the market. Both its products and delivery systems reflect a good understanding of the market in which it operates.
- Although the Capitec experience is unique to South Africa, because the country has experienced an explosion of single or small numbers of branch operators that provided opportunities for Capitec, MFIs can still learn a lot about the development of systems, the focus on achieving one culture in an organisation and opportunities to grow the portfolio rapidly, while keeping quality under control.

- Consolidation of independent micro-lenders has its benefits, but it also comes with major challenges in staff transformation. This is a similar lesson to the earlier lessons of culture differences between commercial banks and NGOs in the microfinance world. In Capitec the challenge is the importance of bringing Finaid branches into the Capitec culture as soon as possible. Capitec has already established a strong commercial culture, and the challenge is to ensure quick conversion to its culture by the branches that it takes over.

In a developed microfinance market a commercial approach towards microfinance can be successful if the institutional capacity exists and is applied in a proper business framework. The founders of Capitec transferred their retail business knowledge to the microfinance market. MFIs without this organisational capacity can learn from successful retailers in their areas of operation.