2022

The future of retail banking in South Africa

Brought to you by Boston Consulting Group
in partnership with Discovery Bank

Contents

South Africa is ready for the future

HARDLY ANYONE TODAY WOULD DOUBT THAT AT SOME POINT IN THE FUTURE, RETAIL BANKING WILL BE COMPLETELY DIGITAL.

With the combination of data analytics, digitised services and personalised marketing that is already available, the day is coming when a customer will be able to conduct every bank service imaginable, from opening an account to managing personal finances or from talking to a consultant to finalising a home loan, with just a few taps or a voice command on a mobile app.

While a completely digital banking environment requires a supporting infrastructure that includes appropriate regulation, advanced security protocols and high smart device usage, many bank consumers believe the digital new dawn for South African retail banking will be a reality as soon as the year 2027.

Discovery Bank and the Boston Consulting Group (BCG) set out to research what to expect for the future of retail banking in South Africa. The majority of the 1,000 consumers and 400 businesses included in the research see the possibility that South African retail banking can become fully digital in just five years.

Given continued regulatory developments, smartphone proliferation and watertight security, there will soon be a limited need for physical retail bank branches as we know them. An evolution in consumer banking expectations has been well underway since early in the new millennium, but it picked up speed when the COVID-19 pandemic forced consumers to conduct more of their activities online, including banking.

We have found, in fact, that many South Africans are fully ready to do all or most of their banking digitally, but in a number of cases, their banks are behind the curve. Consumers want digital solutions that are not only more intuitive, convenient, and secure, but also integrate a large breadth of their banking services into a single ecosystem, accessed through a single interface. Consumers want their banks to redefine service in ways that add value to their lives, especially in personalised, real-time, interactive financial management and in providing cutting-edge fintech.

Equally important, however, consumers want the machine to have a heart. No matter how smart the artificial Intelligence (AI) may be, people want to engage with people, especially when resolving complex, high-value transactions.

How should banks respond? There are multiple business models for the digital age. What they all have in common, however, is that they have bionic features. The initial client interaction is digital, but human engagement is available whenever it is needed, with technology adding value to human capabilities.

As consumers have become accustomed to the intuitive ease of shopping, accessing entertainment, or accessing vast information ecosystems through a few taps on a mobile app, their expectations have evolved. They are now ready for a transformation that will redefine what it means to be a retail bank.

The question is: are banks *ready?*

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Executive Summary

DIGITAL BANKING HAS ACHIEVED UNPRECEDENTED LEVELS OF CLIENT ACQUISITION AND GROWTH OVER THE PAST COUPLE OF YEARS.

Internet banking has grown by a compound annual average rate of 13.6% since 2019, while financial technology (fintech) firms have grown by 12.2% annually in that time. If these growth rates continue, by 2027 the global market value for internet banking is expected to reach $31.8 billion and mobile banking is expected to reach $1.8 billion.

Like retail bank customers all over the world, South Africans have begun to appreciate the speed and efficiency of banking over mobile apps or the internet, leading to a paradigm shift greatly accelerated by the COVID-19 pandemic. Banks throughout the country will need to meet the shift head-on, determining how they will compete as digitisation greatly increases the potential products that a bank might offer, the markets it might serve, and, in the case of long-standing incumbents, the entire infrastructure of existing branches and processes.

It was against this background that Discovery Bank and BCG gathered the views of 1,000 South African consumers from all walks of life, 400 businesses, and several experts from across the globe to explore their views on what lies ahead for the future of banking in South Africa.

We found that the majority of South African consumers (86%) are ready for digital banking as long as the banks provide easy-to-use, secure channels but also make human assistance accessible when needed. More than two-thirds of South Africans (69%) believe that the country's banks will make a full transition to digital banking within the next five years.

The market that a bank serves, however, makes a big difference in the digital readiness of its customers. The wealthiest clients often prefer to engage with humans for advice, while all bank clients also want to know that human assistance is available when they have questions or are conducting higher-end , or complex transactions. Among the approximately 11 million "underbanked" residents of underserved townships or rural areas, the cost of going cashless is often prohibitive. Regulatory changes are needed to drive the costs down and assure all potential users that the cashless system is secure.

The survey looked at the reasons people might continue to go to branch banks or ATMs. Many incumbent banks still insist on in-person on-boarding requirements (58% of survey respondents were required to visit a branch to complete their onboarding), due to legacy systems that banks themselves will need to update. Some customers prefer human interaction, especially for complex needs and transactions, a scenario that calls for banks to keep a knowledgeable staff on board but operate bionically, with technology available to enhance human services. Finally, the population is still at least partially reliant on cash. As many as 95% of people said they withdraw cash from ATMs at least once a month.

There are a number of reasons why certain segments of the population continue to use cash, ranging from long-held habits to concerns about the reliability of online banking to participation in the informal economy. Banks will need to factor in the concerns of their target markets and what they, as institutions, can do to facilitate cashless transactions, thereby building up the critical

volume and aiding the effort to make the formal economy more inclusive. Equally essential, however, is a clear regulatory policy to assure that digital banking is easy, affordable and secure.

The South African Reserve Bank's Vision 2025, scheduled to launch in late 2022, and the Rapid Payment Programme is expected to greatly enhance South Africa's financial inclusion and eliminate key barriers to digital cash transfers.

With most South African consumers ready to do more of their banking through digital channels and the necessary regulatory initiatives on the horizon, retail financial institutions – long-established banks and challengers alike – must consider how increased digital possibilities will change what it means to be a retail bank.

For incumbent banks, digitised banking might mean a complete overhaul of the conventional business model. Even newer players will find that as the banking revolution grows more mature, they will need to define how they're going to continue competing.

To win in the future, players must consider which of a number of viable business models best suits them. We see eight primary business models that will provide digital growth options.

Digitised full-service bank: The bank offers a closed catalogue of its own products through its own best-in-class digital channels and branch network.

Open bank: The bank has its own products but extends its reach by participation in marketplaces and ecosystems and integrating its services with others.

Ecosystem: The institution builds scale in its user base through extensive partnerships that offer a wide range of products and services, including non-banking features.

Product engine: The bank manufactures best-in-class products to be distributed mainly through third-party channels.

Direct bank: This model offers the features of a full-service bank but without a branch network and all transactions are digital.

Neobank: The neobank model is built to be used via a mobile app, usually specialising in a certain niche but providing other products and services through third parties.

Specialist provider: Typically, this is a neobank that manufactures a narrow range of products focused on specific client segments.

Marketplace: An open-bank platform offering a choice of products from competing providers, often across sectors.

In preparing for the very near future, banks and fintechs will need to determine how they will lead the way. The players that stand to win in the digital banking revolution will be those that operate with a clear vision of what it means to be a retail bank in the digital age.

The digital banking revolution is here

SOUTH AFRICA HAS BEGUN TO SEE A PARADIGM SHIFT IN RETAIL BANKING, A SHIFT THAT THE COVID-19 PANDEMIC HAS GREATLY ACCELERATED.

The regulatory climate is catching up with digital innovations such as cashless payments and mobile app deposits. Banks throughout the country will need to meet the shift head-on, determining how they will compete as digitisation greatly increases the potential products that a bank might offer, the markets it might serve, and, in the case of long-standing incumbents, the entire infrastructure of its branches and processes.

It was against this background that Discovery Bank and BCG gathered the views of 1,000 South African consumers from all walks of life, 400 businesses, and seven experts from five continents to explore their views on what lies ahead for the future of retail banking in South Africa.

What the survey found is that a large number of South African consumers are ready for digital banking and expect to see more banks operating virtually in the next few years. Particularly, mass affluent and middle-income clients expressed a preference for conducting their everyday banking activities via an app.

The market that a bank serves, however, makes a big difference in the digital readiness of its customers. Clients at the highest level of income, for example, continue to prefer engaging with humans for advice on more complex banking services.

Middle-income clients also want to know that human assistance is available when they have questions, and many still prefer talking with people when they make higher-end transactions such as a home loan.

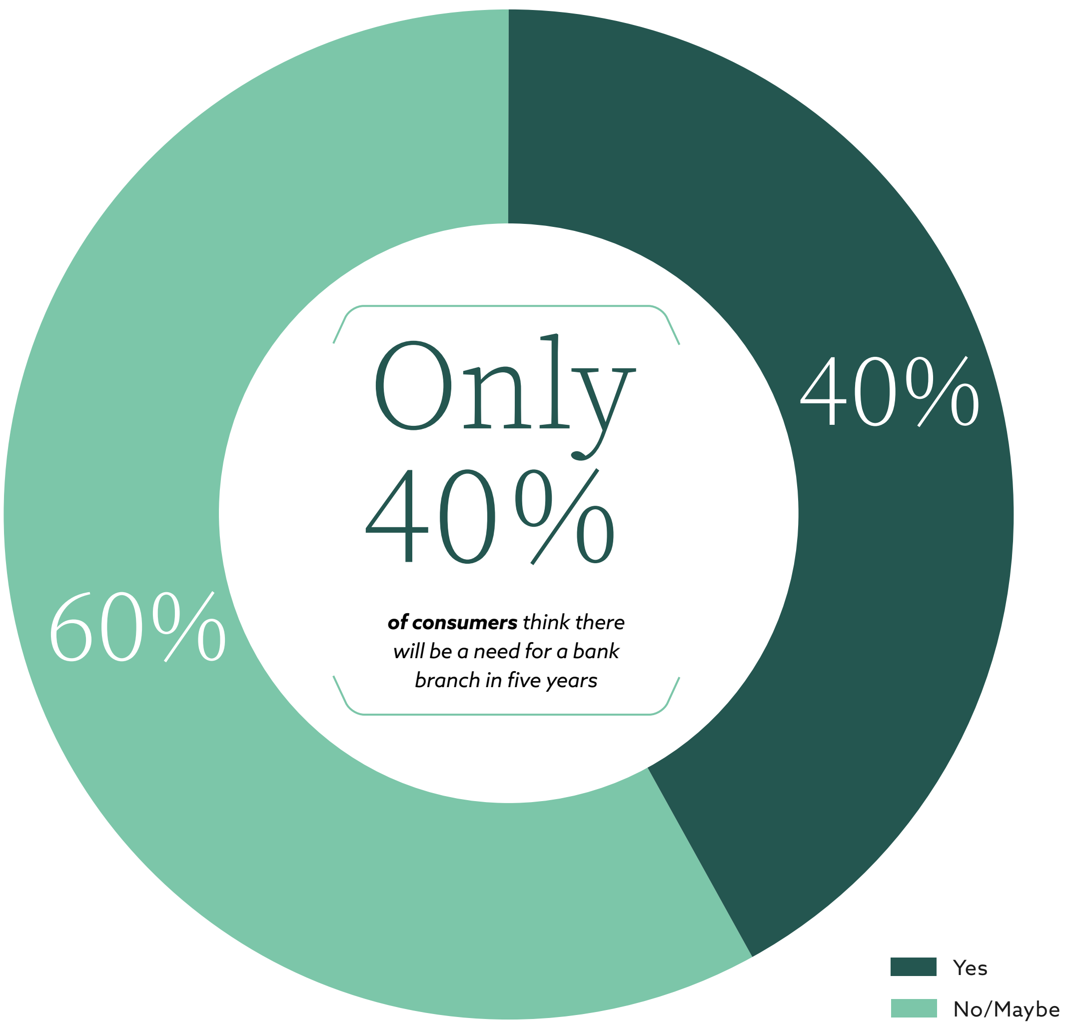
At the other end of the social spectrum, South Africa has about 11 million people known as the "underbanked" because they live in underserved townships or rural areas where there are few bank branches, the economy is largely informal, and "cash is king." The cost of going cashless is often prohibitive in these areas, and regulatory changes are needed to drive the costs down and assure potential users that the cashless system is secure.

Most consumers are ready for digital transactions and services as long as banks provide easy-to-use, secure channels and also make human assistance accessible when needed.

Determining how to harness the full potential of digital banking is not a "down-the-road strategy" because consumers, for the most part, expect to see a full transition before the end of the decade. The Discovery Bank/BCG survey on consumer attitudes finds that more than two-thirds of South Africans (69%) believe that the country's banks will transition to a fully digital banking system within five years.

This consumer paradigm shift goes beyond an expectation that banks will simply offer digital apps and websites atop their core brick-and-mortar services and operations. **A majority of South Africans (60%) believe that in just five years, there may be no need for banks to have physical branches at all.**

DO YOU THINK THERE WILL BE A NEED FOR A BANK BRANCH IN 5 YEARS TIME?



Consumers overall rank mobile banking apps and internet banking as the banking channels that are most important to them – well above the presence of branches or a bank manager. As reliance on digital banking and cashless transactions grows, the importance of physical branches, ATMs and an onsite bank manager is likely to take even more of a back seat to such service channels as call centres and chat services such as WhatsApp to address problems that arise.

RANKING THE IMPORTANCE OF BANKING SERVICE CHANNELS

NOW

Rank	Facility
1	Mobile banking app
2	Internet banking
3	ATM
4	Call centre
5	Financial adviser
6	Branch
7	Bank manager
8	WhatsApp banking service
9	Private Banker

IN FIVE YEARS TIME

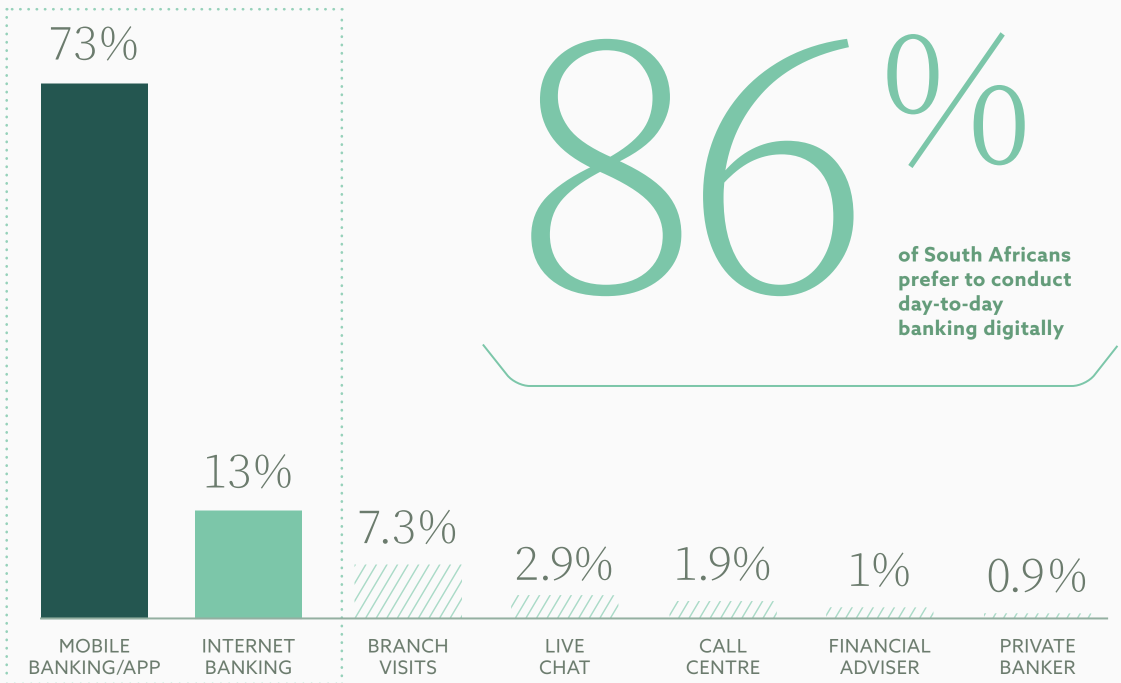
Rank	Facility	CHANGE
1	Mobile banking app	→
2	Internet banking	→
3	Call centre	↑
4	WhatsApp banking service	↑
5	Financial adviser	→
6	ATM	↓
7	Branch	↓
8	Private Banker	↑
9	Bank manager	↓

The vast majority of South Africans (86%), across income bands, have expressed a preference for conducting their day-to-day banking digitally.

Almost 60% of South Africa's consumers say they would be comfortable with a completely digital full spectrum banking offering, allowing them to complete such transactions as securing a mortgage or car loan online.

Day-to-day banking typically involves primary functions such as making and receiving payments, monitoring transactions and checking balances.

WHAT IS YOUR PREFERRED CHANNEL TO PERFORM DAY-TO-DAY BANKING?



For day-to-day banking, consumers far prefer mobile banking using an app over internet banking through a webpage. About 73% say they prefer to use an app, while 13% say they'd choose internet banking.

This overwhelming preference for day-to-day mobile banking reflects South Africa's deep mobile penetration, which has already surpassed 90%, according to a 2021 study by the Independent Communications Authority of South Africa (ICASA).

The preference for mobile banking on an app is expected to increase as smartphone sophistication continues and penetration deepens. However, banks and disruptors will need to increasingly tailor their apps to the needs of specific segments of the population.

On the one hand, age may be less of a barrier to a fully digital transition than it was before the pandemic. Historically, people over 60 years old have been seen as unlikely to use digital channels. Yet the survey finds that more than half of consumers over 60 years old (56%) say they are comfortable with digital banking. The pandemic may have been the tipping point in making digital banking age-agnostic, as people of all generations adopted digital channels to do their shopping, banking, and other activities.

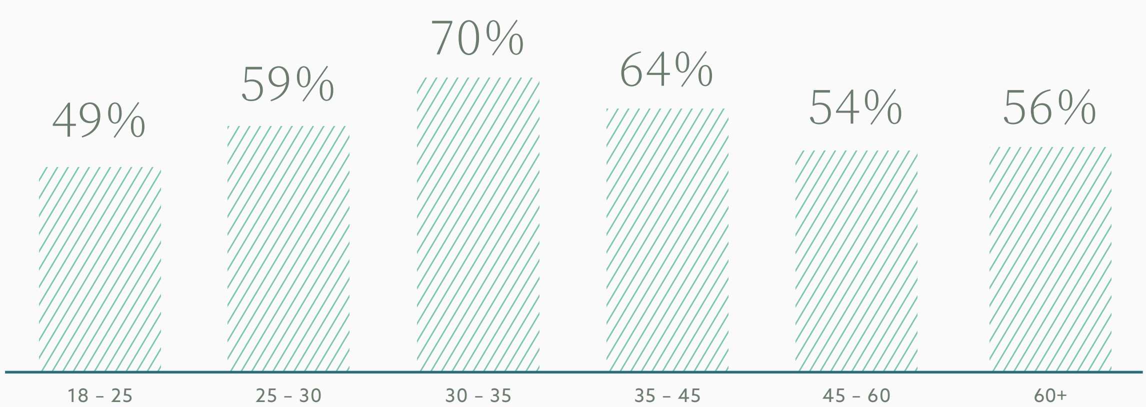
However, South Africa's high mobile penetration rate does not fully reflect the fact that the underbanked population is not always easy to reach with a digital proposition. To grow a market among this segment, institutions and fintechs will need to develop products that serve such needs as low-balance accounts and sending remittances to family in other countries and rural areas.

South Africa's banks have a number of opportunities to grow their customer base with digital tools and strategies. What we have seen, however, is that not all incumbent banks are fully ready for the transformation to digital banking. Many are encumbered with legacy IT infrastructures and processes, as well as brick-and-mortar branch banks with capabilities that might not be what is most needed in the digital world.

58% *of South Africans are completely comfortable using a digital bank*

>50% *of consumers **over 60 years** old are also comfortable using a fully digital bank*

ARE YOU COMFORTABLE USING A FULLY DIGITAL BANK?

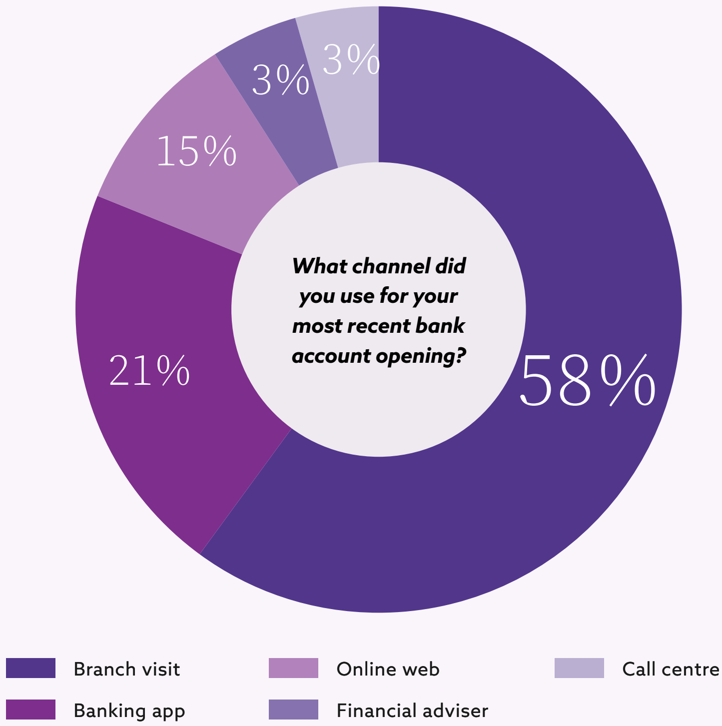


In-person onboarding continues

Despite a high degree of consumer readiness for opening a bank account online or through an app, many bank clients still had to visit a branch to open an account. Of those surveyed, 58% said they had visited a branch to open their most recent bank account.

58%

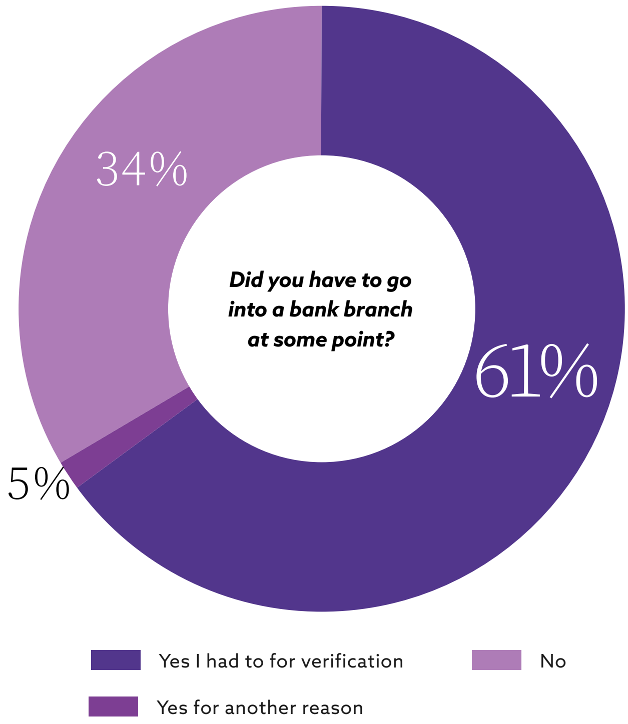
of consumers visited a branch to open their most recent bank account



The main reason they had to go in was for verification. While some of the banks in South Africa have adopted the technology to allow digital customer verification, 61% of consumers surveyed said their bank required that they go into a branch for verification purposes.

61%

of consumers still had to go into a branch for verification purposes



Internal Discovery Bank data reveals that nearly half of unassisted consumers (49%) open an account after business hours or on public holidays when most bank branches are closed, highlighting the added convenience of remote onboarding.

An analysis of neobanks around the world by *Fourtheline Consumer Industry Report* found that all neobanks included in the data provided a complete digital onboarding experience, whereas only 52% of traditional banks provided the service. However, 80% of incumbent banks were deemed to offer an inadequate remote onboarding experience.

Notably, other reasons for visiting a branch relate to a lack of sophistication in the bank's digital interface. For example, the digital offering might not have the capability to resolve an issue, the information might be inadequate or confusing, or the client might have concerns about the site's security. This issue reflects a lack of digital readiness on the part of banks as the main hindrance to digital transformation.

People like doing business with people

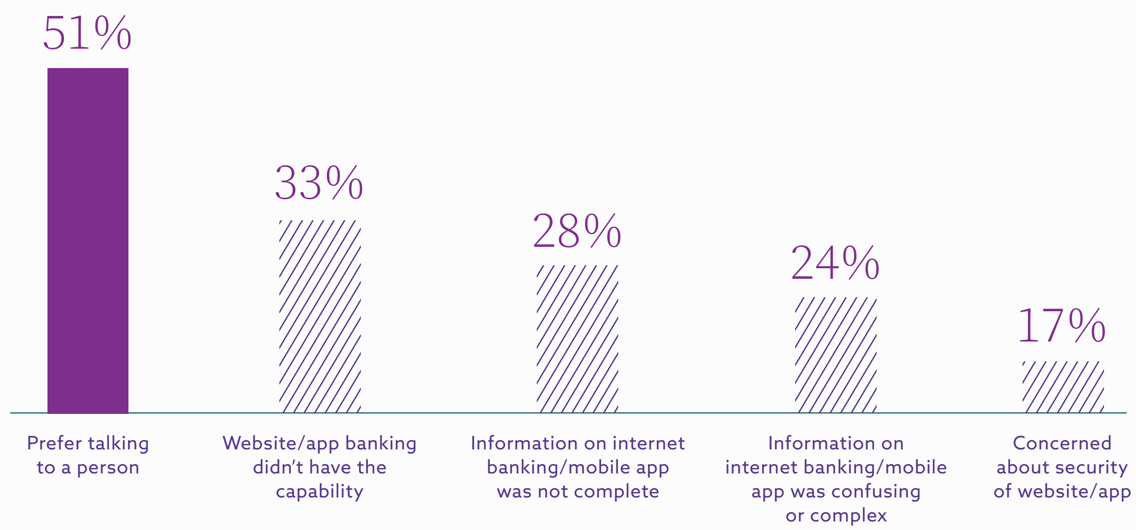
THERE ARE TIMES WHEN CONSUMERS STILL PREFER HUMAN INTERACTION. THIS IS ESPECIALLY THE CASE WHEN THEY NEED TO RESOLVE COMPLEX ACCOUNT PROBLEMS OR CONDUCT COMPLEX TRANSACTIONS.

More than half of consumers surveyed (51%) cited that they "prefer talking to a person" as their top reason for visiting a bank branch.
Furthermore, 31% of South Africans still prefer some human interaction, particularly those over 35 years of age. Overall, however, only 7%, across all income groups, prefer to visit their branch.

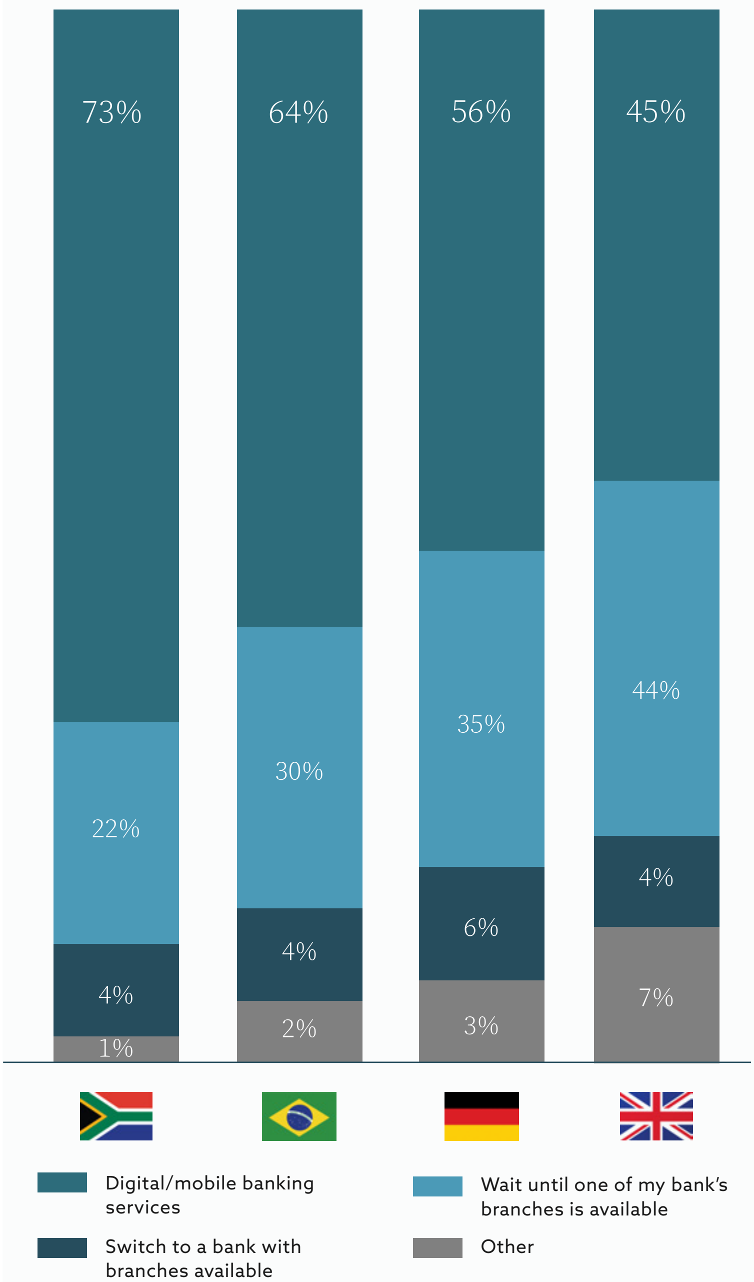
51%

of South Africans visit a branch because they prefer talking to a person

TOP REASONS FOR VISITING BRANCHES



CUSTOMER CHANNEL PREFERENCE IF A BRANCH WAS UNAVAILABLE (% OF RESPONDENTS)



Source: *BCG, ICASA, State of the ICT Sector Report 2020*

Globally, many banks have made the shift to digital for most of their core banking functions, apart from vehicle finance and home loans.

Typically, consumers choose to visit a branch when they are seeking to resolve complex bank account issues or manage high-value transactions.

Yet, personal does not always have to mean in-person. The current-state digital technologies can facilitate, or even enhance, human-to-human engagement.

The march towards digital has been coupled with falling branch traffic. Only 10% of users consider branch visits their preferred channel for most services.

Similarly, when asked what channel they would prefer to use if bank branches were no longer around, nearly three quarters of consumers in South Africa (73%) said they would be comfortable using a digital channel.

Only a fifth said they would wait for a branch to re-open, while a marginal minority said that they would switch banks if their branch closed down.

By comparison, British consumers were split into roughly equal camps between those who would go digital versus those who would wait for another branch to become available. **This is further evidence of a propensity for digital banking services in South Africa surpassing that of more developed economies internationally.**

The data suggests a willingness, if not a preference, among most consumers to use digital channels for all services, even services for which they would typically use a branch. Considering that most banks have not yet made a full-service transition to digital, the findings suggest the potential for a bionic approach.

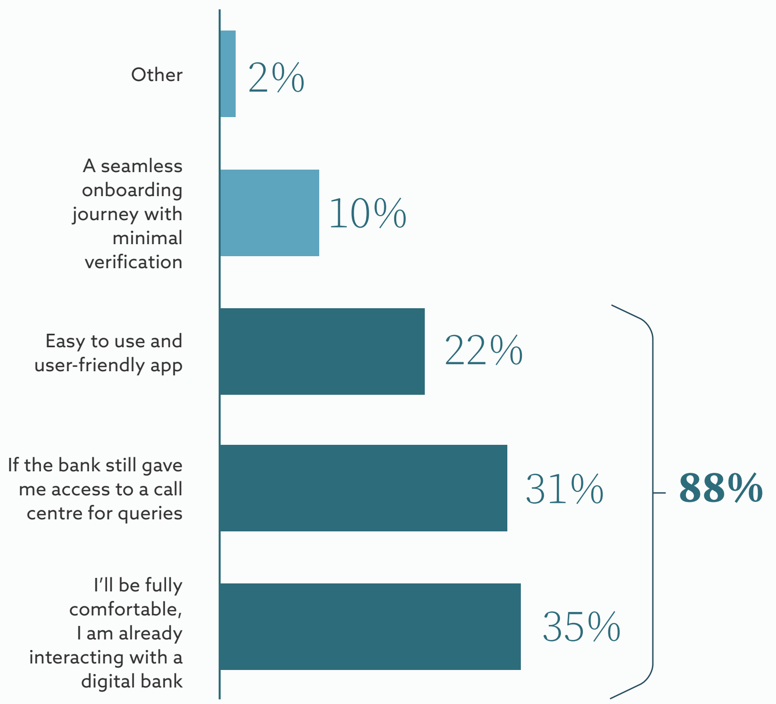
A recent BCG report, *Working in a Retail Bank Will Never Be the Same*, describes the full-service bank of the future as having a bionic distribution network in which technology is used to reinforce the power of human ingenuity and endeavour.

However, a bank doesn't always need a brick-and-mortar presence to operate bionically. If clients are provided with a digital banking service that still gives them access to a call centre for queries, alongside an easy-to-use app, the majority of consumers (88%) say they would be comfortable joining and interacting with a bank that has no physical branches.

88%

of South Africans would be comfortable with a digital bank if it provided a simple and intuitive experience with access to a call-centre

IF THERE WERE NO BANK BANK BRANCHES, WHAT WOULD GIVE YOU COMFORT IN JOINING AND INTERACTING DIGITALLY WITH A BANK?



Internationally, banks are responding to the need for call centres by deploying digital alternatives. AI-enabled chatbots and in-app virtual chat experts have the capability to enhance the personal experience of digital services.

Chatbots can improve customer service productivity, reduce operational costs, and increase the responsiveness to customer requests.

ING, the Dutch multinational banking and financial services corporation, has embedded a customer feedback mechanism that uses AI to allow Marie, its virtual chatbot, to get smarter the more it interacts with customers. Using natural language processing, Marie is now able to understand and address a broad array of client questions. HSBC, A British multinational bank, has deployed Amy as a customer servicing agent that takes the form of a virtual assistant chatbot.

Through virtual or live chats, consumers can acquire banking services or inquire about certain banking services. Typically, the chat service is embedded within banking apps or websites. Frontrunner neobanks, N26 and Revolut, offer this functionality.

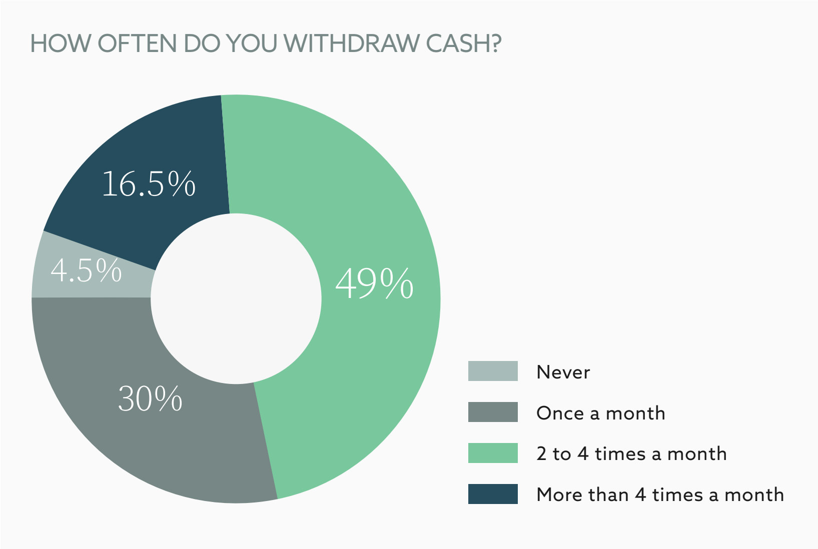
Beyond these replacements for person-to-person engagement, digital technologies have the potential to use such technologies as video conferencing and virtual assistance to streamline client interactions while reducing the need for in-person, face-to-face interactions.

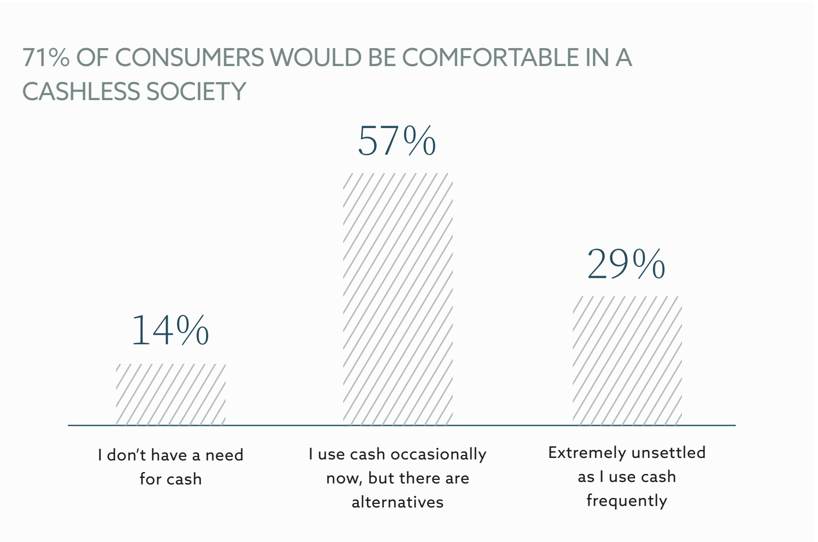
Consumers still need cash

Although a large percentage of South African consumers appear ready to embrace digital banking, the population as a whole is still at least partially reliant on cash. Over 95% of people said they withdraw cash at least once a month.

However, 14% of South African consumers said they don't rely on cash for their transactions, while 57% said they use cash now but are willing to consider alternatives. Only 29% said they wouldn't be comfortable with a cashless society.

While mobile payment services, contactless digital and physical cards, and online banking have reached an advanced stage, these advances have not entirely replaced cash in South Africa the way they have in some other countries. There is an issue of critical volume and as long as a significant percentage of the population uses cash, it will not be possible to move to a cashless system.





There are a number of reasons that certain consumers continue to use cash. They might be simply hanging on to long-held habits. They might be concerned about the reliability of online banking, which is a concern that has been fuelled when banks have experienced online outages.

Those in the low-income demographic might find the cost of cashless transactions prohibitively high. There are also people who remain outside the formal economy and do not want their transactions to be traceable or taxable. On the other hand, cash carries a risk of crime that would be reduced in a cashless economy.

Banks will need to factor in the concerns of their target markets and what they, as institutions, can do to encourage cashless transactions, thereby building up the critical volume and aiding the effort to make the formal economy more inclusive.

Banks cannot accomplish the transition to a cashless society by themselves. A clear regulatory policy is essential to having a roadmap to a cashless society. A number of developing countries around the world have started with less sophisticated banking systems than South Africa and have leapfrogged into digital financial transactions. What has made these advances possible has been a set of policy incentives issued by the central banks to make digital banking easy, affordable and secure.

The Central Bank of Kenya, for example, began working with mobile money operators in March 2020 to facilitate using mobile money transactions as a substitute for cash (See Case Study: Kenya, pg. 32).

While South Africa hasn't been as quick to embrace such initiatives, the South African Reserve Bank (SARB) now has a plan in place, Vision 2025, that is aimed at increasing financial inclusion, reducing dependence on cash, and creating an integrated platform for digital payments.

SARB's Rapid Payments Programme scheduled to launch in late 2022, is expected to eliminate key barriers to digital cash transfers. It will provide a real-time clearing system for instant digital payments between banks, enable the use of identifiers such as mobile numbers and email addresses in place of account numbers, and make it possible for users to request payments from other users digitally.

In addition, there is an opportunity in South Africa for banks and fintechs to reach out to the potential market among the underbanked.

A number of newer players have begun to do this by addressing the large market in immigrant workers who send remittances to their families in other countries such as Kenya and Mozambique. Cash transfers still dominate the remittance market in the Southern African Development Community (SADC), but that is changing as mobile banking platforms including M-Pesa, Mukuru, and SafariRemit build awareness of their services.

One way these industry disruptors have reached people is by having agents at the spots along the Mozambique border where immigrants enter and signing them up with a mobile phone and app.

Remittances are expensive, so higher levels of digital banking mean that low-income immigrants and their families can keep more of their earnings. To develop this market, however, the banks and fintechs need to incorporate financial inclusion strategies that build awareness of digital payment systems and make them easy to access.

Banks must choose their future business models

MANY SOUTH AFRICAN CONSUMERS ARE READY TO DO MORE OF THEIR BANKING THROUGH DIGITAL CHANNELS, OR EVEN PREFER TO BANK THAT WAY. MANY MORE WILL POTENTIALLY USE DIGITISED SERVICES IF THEY HAVE GREATER ACCESS AND CAN BE SURE IT WILL BE EASY, EFFICIENT, AND SAFE.

South Africa is developing the regulatory climate it needs to encourage more digital banking. Following that, it will be up to retail financial institutions – both established banks and challengers – to consider how increased digital capabilities will change what it means to be a retail bank.

For incumbent banks, digitised banking might mean a complete overhaul of the conventional business model. Incumbents need to consider what archetype is going to provide the best strategy for the future. Will they go fully digital, or keep at least some of their branches and create a secondary digital-first brand?

Even newer players that exist to disrupt the old model will find that, as the banking revolution grows more mature and penetrates the market more deeply, they will need to define how they're going to continue competing. What specific products, services and segments of the population must they develop as core capabilities?

With the digital revolution, retail banking will not be a one-size-fits-all proposition. To win in the future, players should consider which of a number of viable business archetypes best suits them. Here we offer the eight primary business archetypes that will provide digital growth options for incumbents and disruptors.

FUTURE RETAIL BANKING BUSINESS ARCHETYPES

OPTIONS FOR INCUMBENTS

Digitised full-service banks

Offer closed catalogue of own products through own best-in-class digital channels and own branch network

Open banks

Produce and distribute own products but extend reach by participating in marketplaces and ecosystems

Ecosystems

Orchestrate products and services (including non-banking customer journeys) through extensive partnerships

Product engines

Manufacture best-in-class products to be distributed mainly through third-party channels

OPTIONS FOR CHALLENGERS

Direct banks

Offer the features of a full-service bank but without a branch network; focus primarily on securing deposits

Neobanks

Built for mobile on a new tech stack; offer a narrow product focus (such as transaction accounts) and import products and services from third parties

Specialist providers

Provide a narrow range of products, typically focussed on a specific product or solution, such as mortgages

Marketplaces

Feature a choice of products from competitors, often including non-banking offerings; have first-class digital user interface and user experience capabilities

Digitised full-service bank: The bank offers a closed catalogue of its own products through its own best-in-class digital channels and branch network. In-person services are available upon request, and the bank is fully bionic, enhancing its human interactions with digital functions.

Lloyds Bank in the UK, for example, is investing in finding new sources of competitive advantages such as open-banking technology and data analysis to meet the needs of targeted customer segments more effectively.

Open bank: In this model, the bank has its own products but extends its reach by participation in marketplaces and ecosystems and integrating its services with others. For example, it might partner with other banks, fintechs or neobanks to offer such services as account aggregation, such as Plaid and Tink, or personal financial management such as the services provided by Mint.

In South Africa, Spot Money SA operates as an open-banking marketplace integrating virtual cards from other banks to create an interoperable payments app. Stitch, a South African API fintech, allows developers to connect apps to financial accounts. This allows users to share their transaction history and balances, confirm their identities and initiate payments.

Ecosystem: An institution acting as an ecosystem builds scale in its userbase through extensive partnerships that offer a wide range of products and services, including non-banking features. The client might, for example, be able to use the bank's web portal or app to access travel or shopping platforms, and apply points accrued through bank transactions to other purchases.

Nedbank customers can use its ecosystem, AVO, to purchase multiple products including groceries, home repairs and appliances. First National Bank, through its eBucks platform, allows access to a wide range of retail, home, and travel solutions.

Insurers have also developed ecosystems. Ping An, a Chinese insurer, has expanded into four ecosystems on top of its core business, so that customers can use the insurer's app to access financial, health care, auto and real estate services. In South Africa, Discovery's Vitality shared-value model uses behavioural nudges and incentivises healthy behaviour through rewards.

Product engine: The bank manufactures best-in-class products to be distributed mainly through third-party channels. A bank that wants to build a large lower-income customer base might, for example, partner with a telecom company that has much greater access to that market than any financial institution has. The bank then designs, for instance, a low-income savings product that is delivered through the telco platform.

Sopra Banking is an example of a company specialising in commercialising its tech stack for banks and other start-ups. This includes middleware solutions, community-based-banking and other software solutions.

Direct bank: This model offers the features of a full-service bank but without a branch network; transactions are all digital. The primary focus is on securing deposits, with services geared to the accounts; for example, using the account to make payments.

mBank in Poland, a market leader in direct banking, acquires and interacts with its clients mostly through digital channels. Its client base is largely under 30 years old,

and university educated.

Neobank: The neobank model is built to be used via a mobile app. The bank's own product range is generally narrow – focusing only on accounts, for example – but it might import other products and services such as forex trading or buy-now-pay-later financing from third parties.

Tyme Bank in South Africa operates as a neobank but leverages its partnership with a leading grocery chain to facilitate account opening.

N26, a neobank from Germany, owns its account relationships but integrates outside products including overseas money transfers, eurozone savings accounts and consumer loans. Importantly, its information technology costs per customer amount to one-sixth of those of conventional banks.

Specialist provider: Typically, this is a neobank that manufactures a narrow range of products focused on specific client segments. Specialist providers in South Africa might, for example, develop a niche market among the underbanked or with small and mid-sized enterprises.

Klarna Bank from Sweden focuses on payment solutions for merchants and consumer credit products specifically designed for ecommerce. Klarna's products are based largely on deferred payments.

Following Klarna Bank's example, Payflex in South Africa is similar, offering six-week interest-free deferred payments for consumers in ecommerce.

Marketplace: An open-bank platform offers a choice of products from competing providers, often across sectors. A marketplace player might aggregate products such as short-term loans or forex trading. It establishes itself as a go-to site for such products by giving customers a first-class digital user experience and interface.

British-based Money Super Market (MSM) has become a market leader in financial products and continues to build its analytics capabilities so that it can offer more personalised recommendations to users.

Joust from USA is a marketplace platform that directly provides merchant services and business banking for the self-employed.

Beyond banking

IN PREPARING FOR A DIGITAL FUTURE BANKS AND FINTECHS WILL NEED TO DETERMINE HOW THEY WILL LEAD THE WAY IN RETHINKING THE WAY RETAIL BANKING OPERATES.

Digitisation opens multiple opportunities but also presents challenges. Well-established banks will need nothing short of a complete transformation of their legacy systems. All retail banks will need to decide upon a business archetype that allows them to differentiate themselves in an increasingly competitive market.

The primary archetype an organisation chooses will determine what infrastructure and what partnerships will be needed. A bank's target market will dictate what capabilities are most critical – it could be product pricing, distribution, sales teams, user experience, customer data, or other ways that establish a competitive advantage.

We envisage a progression of digital banking into super-app platforms for some archetypes, for example ecosystems and neobanks. These platforms will extend the role of banks to offer far more than banking alone. They will create virtual environments in which clients can seamlessly manage a vast spectrum of their day-to-day and long-term investing needs and tasks.

While a bank may choose a dominant archetype, it does not need to be exclusive. For example, Discovery Bank is a new entrant, but has focused on building a full-service retail bank and creating travel and health ecosystems with an emphasis on monetising shared value. Standard Bank on the other hand is a large incumbent that is digitising its primary retail bank, scaling Looksee (an eco-system for home ownership) and offering Shyft (an online forex product).

Industry winners will be those that see ahead to how they might best add value to their clients' lives.

CASE STUDY

THE CASHLESS SOCIETY

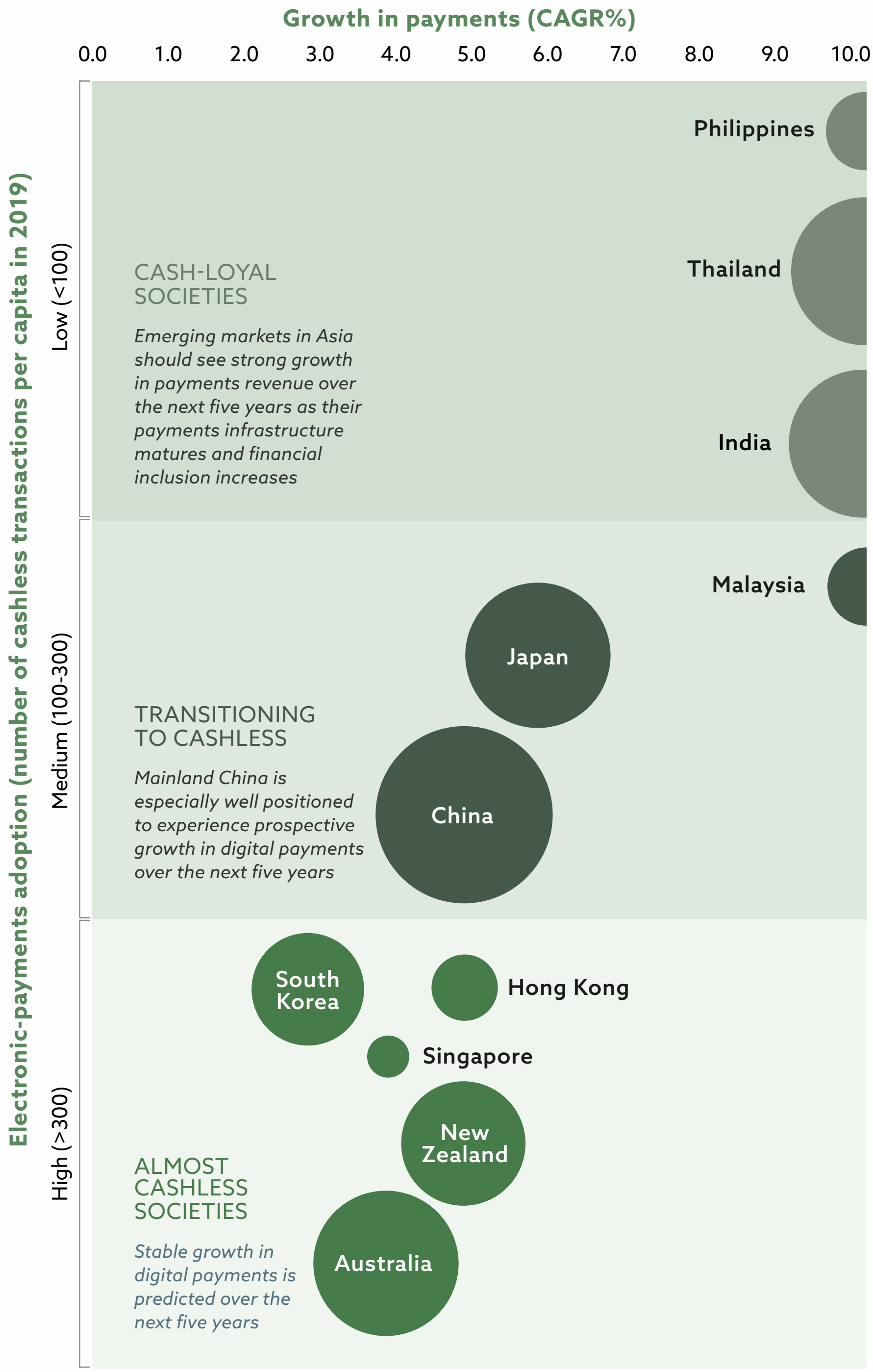
Internationally, countries such as China, Malaysia and Japan have continued a transition away from cash as growth in electronic transactions continues.

The shift away from cash was accelerated by the global onset of COVID-19 and is likely to prove enduring. A BCG survey revealed, for example, that between May and June 2020, many formerly cash-loyal countries, including Germany, Japan, and Italy, saw cash use fall by more than 30%.

In the Asia-Pacific region, large merchants have become major digital payment players, increasing overall payment growth, according to the Global Payments 2020 report study by BCG.

In other cases, new regulations have spurred innovations that are driving growth in cashless payments.

For example, the introduction of Unified Payments Interface (UPI) revolutionised the



Size of bubble = population size
Source: *BCG Global Payments, Fast Forward into The Future*

payments infrastructure in India. Since its launch in 2016, UPI has become the country's most widely used payments platform, establishing behavioural norms that contributed to subsequent strong growth in digital payments.

BCG's Global Payments 2020 report found that UPI's transaction values had grown a staggering 496% annually since inception, compared with just 39% for mobile payments and 23% for credit cards. The platform's interoperability has allowed both foreign tech giants and local ecommerce players to enter the market and build intuitive payment apps targeted at merchants and consumers.

These countries at the head of the path to cashless payments point to models that South Africa can follow as it prepares for a world where cash is no longer king.

CASE STUDY

KENYA – LEADING THE WAY IN AFRICA

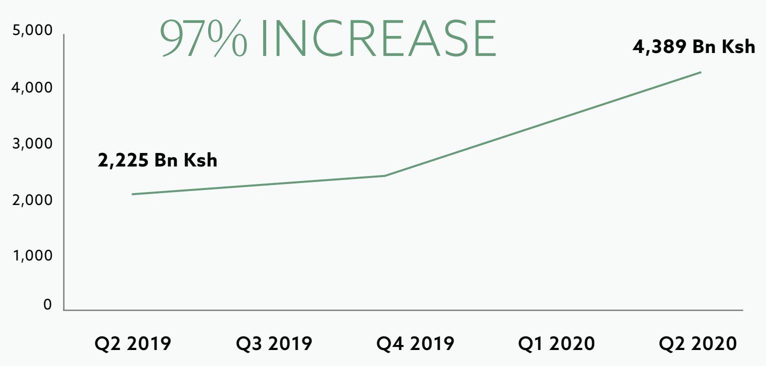
The cashless transition is not a phenomenon isolated to the East or to advanced economies. Closer to home, in Kenya, mobile money transfers almost doubled in value in 2020. The case highlights the potential for a swift transition to cashless payments when the state and industry align.

In March 2020, the Central Bank of Kenya worked with mobile money operators to facilitate the increased use of mobile money transactions as a substitute for cash.

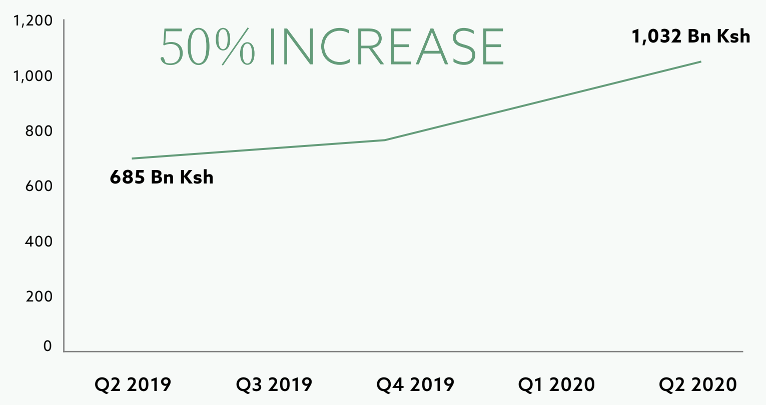
The initiative resulted in several regulatory and industry changes geared towards facilitating the ease and affordability of mobile payments. These include eliminating charges for micro-transactions and increasing the ceiling on transaction values. Charges for transfers between mobile phones, money wallets and bank accounts were eliminated.

As a result, the total value of mobile money transfers increased by 97% from October to December 2020. Kenya and South Africa are similar in terms of literacy rate, population and percentage of the population working in the informal sector (20% to 25%). Kenya's transition offers proof that a cashless society is achievable even in countries with large informal sectors.

TOTAL VALUE OF MOBILE MONEY TRANSFERS (BILLION KENYAN SHILLING)



P2P TRANSFERS (BILLION KENYAN SHILLING)



CASE STUDY

NEOBANKS – DIGITAL PATHFINDERS

Neobanks have seen explosive growth in terms of both client acquisition and app downloads in the last few years as consumers discover their advantages. Clients benefit from personalised experiences, low-friction app downloads and rapid onboarding experiences. Know Your Customer (KYC) identification procedures are typically completed within five minutes.

Neobanks are also providing customers with more competitive services than traditional banks. For example, Revolut, a fintech and digital bank operating in 28 Western countries, offers commission-free foreign exchange services. Customers can make transactions in over 150 currencies at the interbank rate and exchange 24 currencies with no commission on trades of up to £5,000 per month.

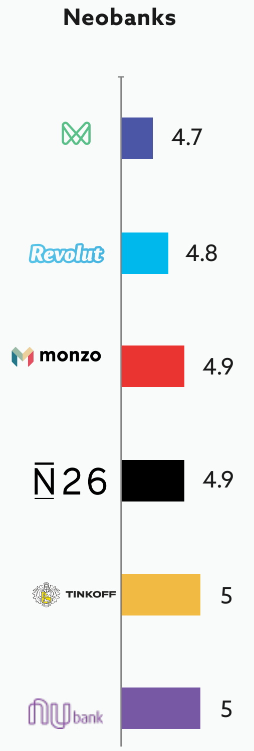
The attractiveness of these offerings is reflected in the consumer rating scores for neobank apps, which typically surpass those of their more traditional rivals by far.

Worldwide, total downloads of neobank apps exceeded 264 million between 2015 and 2021 according to App Annie data analysed by *Business of Apps*.

As customer acquisition has exploded, global neobanking exceeded US $45 billion in 2021 and is anticipated to grow at a compound annual growth rate of more than 45% from 2022 to 2028, according to Global Market Insights.

However, many neo banks are still not profitable and their ability to convert client growth into a primary relationship and generate revenue is being questioned. According to Morgan Stanley, incumbent banks in the UK and France, where many of the world's foremost neobanks operate, still have the majority share of primary accounts (60%). Whilst neobanks have focused on client acquisition and driving transaction accounts and savings products, they need to generate sustainable NIR and accumulate assets through products such as short-term lending, credit cards and mortgages in order to define a clear path to profitability.

APP RATINGS (OUT OF 5)



Acknowledgements

DISCOVERY BANK

- **Hylton Kallner I** *CEO*
- **Akash Dowra I** *Head of Client Insights*
- **Yusuf Abdoola I** *Technical Marketing*
- **Natasja Botha I** *Marketing Expert*
- **Roann Slabbert I** *Marketing Manager*
- **Jo-Anne Hendricks** | *Head of Marketing*
- **Zeenat Moorad** | *Public Relations Manager*

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08/22

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