FINANCIAL SERVICES FIRST PAPER

The Scope of the Financial Services Sector Industry in the Western Cape

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EXECUTIVE SUMMARY

A. State of the sector in the Western Cape

1. *Economic activity*: The average contribution of financial services to provincial GDP between 1995 and 2003 was 12.3%, 3rd largest in the province of 26 sectors. Growth of financial services sector in the Western Cape was been 6.11% *per annum*. The Western Cape contributes 21.7% to financial services output nationally. Investment in the FIRE – finance, insurance, real estate and business services –sector[1] has dominated GFCF in the Western Cape province, averaging 32.7% of total investment, with an investment rate (investment as a share of sector value-added) averaging 23.7%, well above the national average rate. Since 2000, however, the sector's investment has been less vigorous than before.

2. *Employment*: The sector employed over 65000 people in the province in 2003, 5% of formal employment. Sectoral employment has grown at 1.1% per annum, while overall formal sector employment has declined. Since employment growth has been much slower than output growth, labour productivity has risen with capital intensity. Financial services employment in the province is heavily skewed towards insurance with 58% of the labour force, while the banking sector provides 31% and the securities trading segment 11%. The Western Cape has one-third of the national labour force in the insurance branch.

3. *Head office location*: This is critical for employment and policy impact. Three of the top five insurance head offices are in the province (and ten insurance companies in total), but only one domestic bank and one foreign bank. Most stockbrokers have Western Cape branches rather than head offices, but eleven of 26 asset management companies are based in the province.

4. *Labour force composition*: The three branches of financial services have a broadly similar occupational structure: about half the labour force in clerical and sales occupations where the entry requirement is matric. About one fifth are technicians and associate professionals and another fifth professionals. Senior management comprise ten percent. Indians and 'coloureds' have advanced in the top two occupational categories to representation close to their population shares, but Africans are severely under-represented. Africans' share of lower skill white-collar (clerical and sales) jobs is significant, and whites are a minority in these categories. Coloureds fill a very large proportion of the technical and clerical jobs in insurance. Women are well-

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[1] Investment data is available only for the FIRE sector as a whole at the provincial level.

represented at the top of the occupational ladder though the insurance industry is lagging the other two branches, while the clerical and service/sales categories are predominantly female.

5. *Access to financial services*: Only 39.5% of the Western Cape's population are unbanked, compare with 54.6% nationally. Less than a quarter of the WC population have never had a bank account. But while a small share of 'coloured' people have never had a bank account (25.6%), a very high proportion – nearly 23% of the total 'coloured' population – have had bank accounts but no longer do, about double the proportion in SA as a whole. In April 2005, about ten percent of the 827 000 Mzansi accounts were in the province, mostly in the rural areas. One of the four major banks reported that just under half of its accounts were 'entry-level' including Mzansi and low-income customers. With very low formal savings in low income groups, a tiny proportion (below 5%) use life assurance/savings products such as endowment policies, though a significantly larger number own funeral policies (8.4%) or burial society memberships (29.8%).

6. *Banking*: Banking sector assets have grown consistently faster than (nominal) GDP since 1995, though the number of banks has declined since 2000, as most of the smaller banks disappeared in 2001/2, and foreign bank interest in South Africa also declined before its recent revival with the Barclays takeover of Absa. Banking sector growth reflects (and reinforces) the overwhelming dominance as a group of the four major retail banks, though there is competition amongst them for market share of specific products (such as home loans or credit cards). Their control over the national payments system and dominance within ATM and sales point networks underpin fee structures which are very high by international standards. Nonetheless, smaller banks are profitable, if few in number.

7. *Life insurance*: This sector has done poorly over the past decade. Premium income has declined due to shifting demand for financial assets by existing consumers and the slow entry of low-income consumers. Investment income from the equity market has also declined, due to dropping domestic inflation and interest rates and a volatile international market. Poor revenue has increased cost pressure and lowered employment. Domestic market structure has shifted substantially: the two leaders historically – Old Mutual and Sanlam – have lost market share in new business, and there has been substantial consolidation via mergers and acquisitions, including the loss of two of the Western Cape's five major head offices since 1998. Old Mutual and Sanlam have adopted contrasting strategies. The former has internationalised, broadening its focus from insurance to financial services and from South Africa to the industrialised countries –

it is growing rapidly in the US and has repeatedly tried to establish itself in the UK and Europe. Sanlam continues to focus domestically, aiming at new market segments, especially low-income and Gauteng consumers, with limited international expansion focussed on emerging economies. Cost-cutting via retrenchments and relocation of some business units to Johannesburg has reduced the company's Western Cape labour force. Metropolitan Life, the 3rd Western Cape company, has grown rapidly and won market share from its two local rivals in recent years, but is rumoured to be a takeover target for Sanlam.

8. *Short-term (general) insurance*: This sub-sector has been on a rapid upswing since 1999, with rising income and dropping claims, and cash flows generated by subsidiaries in this sector have supported Old Mutual and Sanlam. There has been entry by new firms as well as some foreign investment.

9. *Securities trading and asset management*: Both the Johannesburg Stock Exchange and the Bond Exchange of SA have grown exponentially since the mid-1990s, with an increasing share of foreign transactions. This has produced a rapid increase in the numbers of asset managers, employing small numbers of high-skill people.

B. <u>Issues and trends in financial services</u>

1. *International*: Over the past two decades, policy deregulation and liberalisation of financial systems and the development of IT and telecoms systems have led to the globalisation of financial services, but also increased risk due to cross-border contagion and asset price volatility. A major current threat to international stability is exchange rate misalignment between the US dollar and the Chinese yuan. Though this reflects trade and capital flow interdependencies, a sudden re-alignment could produce commodity price collapse and an outflow of funds from emerging markets and be costly for the financial services sector and the SA economy.

2. Greater risk of financial collapse has led to multilateral efforts to strengthen regulation, in particular the Basel II accord on capital adequacy, which expands the definition of risk from Basel I, and places a greater burden on self-regulation by banks and on market-based regulation. Basel II has a cost however. Banks will have to improve risk measurement systems using substantial human and financial resources. The new approach may be contractionary in the wider

economy, and raise the cost of capital especially for small borrowers. South African banks and regulators are implementing Basel II very conservatively.

3. The GATS (WTO) negotiations are ongoing, though agreement may be four or five years away. The EU and the US are demanding the opening of South African financial services to easier foreign entry. This may threaten dominant domestic institutions but may promote competition by breaking the major banks' control over the national payments system, and exports by increasing outsourcing.

4. A new distribution and service model is emerging which combines a diverse set of sales activities with centralised administrative operations. Direct personal service and electronic provision are increasingly complements rather than substitutes, with significant implications for skills requirements and organisational structure. Banks are promoting transactions volume and scope to raise fee-based revenues, and branches become sales points for customer contact. In insurance, cost pressures promote scale-based administration while stronger consumer protection and shrinking markets widen product ranges and distribution methods, such as worksite marketing, bancassurance and tied agents. These shifts will lead to massive growth internationally in the distinct activities of business process outsourcing (BPO, back office administration and remote client servicing) and call centres (inbound and outbound voice-based sales and service).

5. *National*: The Financial Services Charter (FSC) is the major domestic trend. All the major financial services groups have concluded deals to meet equity targets. The empowerment consortia involved will also contribute to transformation of procurement, staffing and BEE financing in other sectors. Though short-term staffing targets will be met, recruitment from a restricted labour pool may intensify shortages of high-skill employees over time and contribute to the shift to flatter organisational structures and scale-based service models. Input procurement is becoming decentralised, and institutions' buying power could strongly promote small and medium black entrepreneurs, but with possible negative medium-term cost implications. If BEE commitments are met, their financing will amount to a significant share of overall credit flows, and together with Basel II criteria, may impact on credit extension for growth.

6. FSC requirements for extending financial access are likely to be met if competition is increased in the low-income retail banking market. Foreign entry, especially by developing country banks may have some impact. Non-banks (retail chains, cellphone companies) are entering banking, and

will be encouraged by a new regulatory framework which eases entry restrictions. But the major banks are internalising the competitive threat by establishing partnerships with non-banks, exchanging access to the payments system for new distribution channels in line with the new business model.

7. All the major SA banks and insurance companies are expanding into the rest of Africa and beyond. With rapid growth and relatively high returns on equity, this will absorb a growing share of human and financial resources, but also increase demand for service provision from within the institutions' South African operations.

Introduction

It is worth starting by spelling out three relevant characteristics of the financial services sector, which, even if obvious, have important implications for policy at the sub-national level:

(i) Notwithstanding significant changes in the content and delivery of financial services as a result of the interconnected processes of IT development and economic globalisation, it remains a service, that is, it is produced and consumed simultaneously and thus requires direct contact between producer and consumer. Furthermore the elements of risk and time involved in almost all financial services transactions underpin ongoing contact between producer and consumer, after the initial transaction, and often requiring human intervention. This provides scope for output growth and employment in specific localities, since the producer must have a labour force available to the consumer.

(ii) Financial institutions and the financial system as a whole play the critical role of intermediation between (financial) surplus and deficit units. This involves decentralised processes of collection and distribution of funds, combined with the centralised pooling of these funds and their management and allocation. This process imposes a 'head office and branch' structure (or at least a 'hub and spoke' form) on financial institutions. This implies that firm decisions about corporate strategy, including the location of their branches, are taken essentially at national, rather than local or regional, level.

(iii) The financial sector's role, and especially the banking sector's, in the wider economy implies that the financial system's health is critical to aggregate economic stability and growth, implying that financial sector growth and competition needs to be balanced with the need to avoid collapses and their knock-on effects via financial regulation. Therefore as with corporate strategy, there is an inherent emphasis on centralised, national level, control.

Both the latter points will limit the tools and options available to regional or local governments wishing to impact on the financial sector.

Section 1 of this paper presents a sectoral profile of the financial services sector in the Western Cape. This spells out the sector's contribution to provincial output, fixed capital formation and employment, as well as the Western Cape's share of these variables within the financial services sector in the South African economy as a whole. The profile then examines the structure of the labour force, looking at occupation and skills, and racial and gender composition. The final part of the profile turns to the demand side of the sector, presenting data on access to financial services for the population in the province. Section 2 of the paper examines the structure and recent performance of the three main sub-sectors within financial services, that is, banking, insurance and securities trading. Section 3 turns to trends within financial services, looking at international and national trends in turn.

2. <u>Profile of the Financial Services Sector</u>

The financial services sector is defined here as including SIC sub-sectors 81, 82 and 83, that is, financial intermediation, insurance and pension funding and 'activities auxiliary to financial intermediation' respectively. In other words, the focus is on banking, insurance, securities trading and financial market administration, as well as some less significant activities in auxiliary activities such as debt collection and company secretarial services.

This section uses provincial data, where available, together with national data to present a profile of the financial services sector in the Western Cape. For some variables, only national data is available, providing the best available approximation to the Western Cape's situation. In addition, for some variables, data is obtainable only at the 1-digit SIC level, in which Financial Services are aggregated with Real Estate and Business Services into division 8, the Finance, Insurance, and Real Estate ('FIRE') sector. In addition, the top management team of the Western Cape retail operation of one of the four major banks were interviewed for this study, as were several managers of one of the province's major insurance companies. This has made it possible to present some provincial perspective as well.

Despite its limitations, this data helps to provide a sectoral profile which illustrates the significance of the sector within the Western Cape, which in turn underlines the need for consideration of more focussed sub-sectoral data collection within the province. The discussion proceeds following the tables.

<u>Output, distribution and investment</u>

(i) Table 1[2] shows the contribution of the financial services sector to the Western Cape economy. In 2003, the sector contributed R18.47 billion, 13.8% of the provincial GDPR. The average contribution of financial services to provincial GDP between 1995 and 2003 was 12.3%, the third-largest sector in the province (in the 26-sector disaggregation). The largest sector was real estate and business services, 14.7% of GDPR, followed by wholesale and retail trade which averaged 14%. Financial services is on average about half the size of the entire secondary sector in the province. The table also shows that the growth of the financial services sector in the province has been considerably larger at 6.11% *per annum* between 1995 and 2003 than for the economy as a whole, which averaged 3.3%, or for the secondary and tertiary sectors. Financial services also grew faster than real estate and business services (3.97% *per annum*) so that the FIRE sector as a whole grew at 4.95% *per annum*, and wholesale and retail trade (5.16% *per annum).* The financial services sector's share increased by 2.7 percentage points over the 8 year period.

(ii) Table 2 locates the provincial financial services sector within the context of the national financial services sector. The Western Cape contributes more than one-fifth - 21.7% - to financial services nationally, which is far greater than the province's contribution of 14.2% to national GDP. The sector is much larger in the Western Cape economy than it is in the South Africa economy as a whole: the sector's average share over the period is only 8.1% of national GDP,

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[2] Tables 1-3 and 5-7 are based on data provided by Quantec Research and the Bureau of Economic Research, which make possible the disaggregation of the FIRE sector into financial services ('F&I') and real estate and business services. The data also provide more detailed disaggregation of the financial services sector data, both provincially and nationally, than was available for the PERO. This has made it possible to present a more accurate picture of the sector's provincial contribution than in the PERO, particularly with respect to Gross Fixed Capital Formation. However, there are still inaccuracies in the data, according to Quantec, who are now preparing new provincial data which promise to refine the financial services data even more.

considerably smaller than its 12.3% average share of the Western Cape's GDPR. But the sector, based primarily in Gauteng, has grown even faster nationally than in the Western Cape, 7.9% compared with 6.1%, and its share in national GDP has increased significantly over the period, by three percentage points from 6.7% to 9.7%. The WC is contributing a smaller proportion to this national growth in 2003 - 20.7% - compared with 23.7% in 1995.

Table 3 shows the financial services share of the FIRE sector for South Africa and for the Western Cape. In both the province and the country, financial services has grown faster than real estate and business services, and its share of the FIRE sector has in consequence risen significantly. Like financial services, the business services sector has grown much faster than the economy as a whole, but the real estate sector has lagged well behind, essentially stagnating between 1995 and 2003.

(iii) Table 4 shows that the distribution of Gross Value Added in F&I compared with that in the economy as a whole. As expected, the F&I sector uses a far smaller proportion of intermediate goods in producing its output only 38.5%. It is also interesting to note that wages and salaries only comprise 38.1% of value added, which is a much smaller proportion than the rest of the economy, even though the wage *rates* may be higher on average in the F&I sector. Profit (gross operating surplus) takes a correspondingly larger share in the sector than in the national economy as a whole. This is one factor in the very high investment rates (that is, the share of sector value added going to fixed capital formation) by comparison with the rest of the economy, to which we now turn.

(iv) Tables 5 and 6 look at Gross Fixed Capital Formation. Data for GFCF in financial services as a separate sub-sector is not available for the Western Cape, and only data for FIRE GFCF can be presented. At the national level, GFCF in the FIRE sector can be split into financial services and the rest of the FIRE sector, that is, real estate and business services, and for each of the two sub-sectors of FIRE, GFCF data is available for different assets: buildings, machinery and transport equipment.[3]

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[3] Tables 5 and 6 exclude 'transfer costs' from GFCF in the F&I and FIRE sectors for the Western Cape and for South Africa. These costs are associated with investment in all sectors, but Gross Fixed Capital Formation data in the national accounts includes transfer costs for the entire economy in the 'Finance & insurance' sub-sector, inflating this sector's investment data. Transfer costs averaged 3.16% of GFCF as a whole for South Africa between 1995 and 2004, and were 14% of GFCF in the FIRE sector and 31% of GFCF in Finance & insurance. Deducting transfer costs from F&I and FIRE sectoral data provides a more

Table 5 presents the detailed picture available for the financial services sector's GFCF for the South African economy as a whole. The FIRE sector accounted for a very stable share of GFCF nationally between 1995 and 2004, with its average share of 19.5% higher than its share in GDP of 17.1%. Annual growth in FIRE GFCF was 3.8% through the period, but in F&I considered alone, growth was much stronger at 5.56% *per annum.* As a result, F&I GFCF increased its share within FIRE GFCF by more than five percentage points, from 32.8% to 38.1%, and its share of economy-wide GFCF rose slightly from 6.5% to 7.1%, averaging 7.0% over the period. Looking at the F&I sector, GFCF averaged only 14.9% of the sector's value-added over the period, quite significantly less than the economy's average of 17.2%. Even though the sector's investment performance was relatively strong compared to other sectors., it did not fully reflect the very strong growth performance in the sector (7.9% growth *per annum*). The table also presents data on the composition of GFCF in F&I by asset. The share of machinery & equipment has risen steadily from 18.6% to 27.0% of the sector's GFCF, reflecting the investment in IT and electronic service provision (eg. ATMs, call centres, etc). At the same time, the share of buildings dropped until 1999, perhaps reflecting the contraction in branch networks. Since 1999, investment in buildings has increased at the expense of transport equipment.

Table 6 presents the GFCF data for the FIRE sector in the Western Cape, the most detailed disaggregation possible at the provincial level. Investment in the FIRE sector has dominated GFCF in the province over the past decade, averaging 32.7% between 1995 and 2003 and 33.3% between 2000 and 2003.[4] The FIRE share of total GFCF is far higher in the Western Cape than it is nationally (19.5% average). This high share is partly due to the low investment in other sectors within the province, reflecting low growth in the primary and secondary sectors within the province. But FIRE sector investment in the province has been very strong: the investment rate (investment as a percentage of sector output or value-added) has been remarkable, averaging 23.7% through the period, and peaking at 25.7% in 2000. This is far higher than either the average investment rate for the FIRE sector nationally of 17.9% or the average investment rate (GFCF to GDP) for the SA economy as a whole of 17.2%. Perhaps most significant, it is also far higher than the average investment rate in F&I nationally of 14.9%. FIRE GFCF in the province

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accurate picture of actual fixed investment in the sector. Transfer costs have not been deducted from total GFCF data for the Western Cape or SA.

[4] This confirms the broad picture of provincial GFCF dominated by the FIRE sector, as presented in the *Western Cape Provincial Economic Review & Outlook* (Western Cape Provincial Treasury, 2005). The FIRE investment share here is lower because the PERO data included transfer costs in the sector's GDFI, resulting in an inflated sectoral share of provincial GDFI.

grew at an annual rate of 4.7% between 1995 and 2003, more strongly than the sector at the national level, so that its share of FIRE GFCF nationally increased from 24.1% to 29.2%, which is much higher than the Western Cape's share of value-added in FIRE nationally, which averaged 20.3%. Without more disaggregated data, it is hard to be sure whether this strong investment performance has been due to the financial services branch or to real estate and business services, or both. But if the financial services investment rate in the province had lagged at around the national level of 15%, the investment rate in real estate and business services would have had to be extremely high to account for the very high rate within the FIRE sector overall, particularly since growth in financial services has been stronger than in the other sub-branches of FIRE within the province (Table 2). Thus, there is reason to believe that the financial services investment rate has been higher in the Western Cape than nationally, as well as considerably stronger than in other sectors within the province.

Figure 1 qualifies this picture somewhat, suggesting that the WC FIRE sector's strong investment performance relative to the rest of the economy may not have been sustained throughout the decade. The graph presents the year-on-year changes in GFCF for financial services nationally and for the FIRE sector both nationally and for the Western Cape. GFCF in financial services nationally was quite volatile at the end of the 1990s with GFCF in the overall FIRE sector and across the economy as a whole also fluctuating considerably. In contrast, FIRE GFCF within the Western Cape was more stable during those years, maintaining growth above 5% year-on-year and outperforming the other indices shown. Since 2000, however, it has continued to grow each year, with a positive rate of change, but the increases have been smaller, below 5% *per annum.* FIRE GFCF in the province appears to have weakened relative to the FIRE sector nationally and to South African GFCF overall. Thus looking over the past decade as a whole, financial services investment in the province has done well, but it cannot be presumed that it will continue to lead overall investment into the future. Further research is needed to fully understand the historical investment pattern and investment behaviour within the financial services sector in the province, particularly to examine the impact of head offices and their location on investment decisions by financial services firms.

Location of firms and labour force

(i) Table 7 shows the financial services sector's contribution to formal employment in the Western Cape. The sector employed over 65000 people in the province in 2003, with its share of formal employment in the province 5% through the period since 1995. However, there have been some fluctuations in sector employment with some decline since the peak level of employment in 1998. Not surprisingly, financial services share of employment is much smaller than its share of value-added in the province, which averaged 12.3% *per annum* (Table 1). Total national employment in financial services was about 350 000 in 2003 (Quantec, 2005), and the Western Cape's share averaged 19.6% over 1995-2003, close to its average share of value-added nationally of 21.7%.

Financial services employment in the Western Cape has grown rather slowly at 1.1% *per annum* since 1995, though this is well above the overall provincial growth rate of formal sector employment of -0.33% *per annum*. Provincial employment growth in financial services has also been much slower than output growth in the sector of 6.1% (Table 1), suggesting that the sector's capital-intensity has risen within the province. A similar trend is evident nationally, where employment growth in financial services has been 2.3% (faster than in the Western Cape) compared with 7.9% annual growth in output, suggesting that capital-intensity has risen even faster at a national level than in the Western Cape.

(ii) Table 8 uses data from the three SETAs in financial services – Bankseta, Inseta and Fasset – to present a more detailed picture of employment distribution in the sector, both geographically and across the branches of financial services, banking, insurance and securities trading and ancillary activities. The data for the three sub-sectors was collected at different times, and using somewhat different methods from each other, and different sectoral and branch definitions than the official labour market statistics. The table should therefore be taken as indicative rather than authoritative, but it nevertheless provides an illuminating picture.[5]

Notwithstanding this qualification, the SETA data in Table 8 are broadly consistent with the StatsSA data presented in Table 7.[6] Total employment in financial services in the Western Cape is reported at close to 65000, and the Western Cape's share of national employment in financial services is just over one-fifth at 22.6%. Within the Western Cape, financial services employment is heavily skewed towards insurance, which provides 58% of the total. The banking sector provides 31% of provincial financial services employment, with the securities trading segment much smaller than the other two at 11%. Nationally, the shares are different: 49% in banking

[5] The securities trading sector has been defined here as including only three of the seven branches covered by the Fasset SETA, as the other four were deemed to be part of business services, rather than financial services.
[6] The national total differs however by nearly 20% from the StatsSA data, according to Quantec (2005).

(with Gauteng overwhelmingly dominant in this branch), 38% in insurance, and the remaining 13% in securities trading. The Western Cape has about a third of the national insurance labour force, but only one in seven banking employees nationally.

The lower half of Table 8 underlines the concentration of employment in the large corporations within the sector. This is particularly true in banking, where the five major banks employ over 80% of the branch total.[7] In the insurance sector, the four major corporations (identified by share of premium income) employ about 39% of the national labour force in large insurance companies. Two of these have their head offices in the Western Cape, Old Mutual and Sanlam, as does the sixth-largest, Metropolitan Life. This illustrates the importance of head office location in the 'hub and spoke' corporate structure most common in financial services. As shown in Table 9, only one bank has its head office in the WC, and only one foreign bank of 54 branches and representative offices has located itself in the province. Similarly, in securities trading almost all head offices are in Gauteng, with branches located in the Western Cape: only three of the 26 brokerages in the province are identified as sole branches. The Association of Unit Trusts has 26 members, managing 517 unit trusts worth R303 billion in September 2004 (Unit Trust Survey, 2004). Sixteen of the 26 management companies are located in the Western Cape[8]. The management companies located in the Western Cape include divisions of several corporate groups headquartered in Gauteng. In total, the Western Cape-based managers operate 247 trusts (48%) worth R110 billion (36.1%) of the assets. Total employment in unit trust management operations is apparently very small, however, averaging around 100-200 per firm, mostly in high-skill categories.

While head office location shapes the distribution of employment, local management in the provinces have a certain degree of autonomy from the national centre in regard to operational decisions, at least in banking. The four major banks all operate on the basis of federal-type structures reflecting product and geographical segmentation of bank operations. For example, the interviewees' bank has two Western Cape divisions for retail and corporate banking respectively, which operate quite independently of each other, and report separately to national management in Johannesburg. The two divisions operate as notional profit centres, and compete with other divisions for shares of the total organisational budget, both capital and operational. Overall

[7] The total for the five banks is based on their 2004 annual reports. A survey of these institutions' employment in early 2003 reached a very similar number: 113240 (PWC, 2003).
[8] In addition, 8 of 12 affiliate members are in the Western Cape.

strategy is determined nationally but regional managers have responsibility for implementation – the divisional manager interviewed drew a distinction between strategies which are decided centrally and tactics which are his responsibility at the provincial level. The degree of centralisation varies amongst the banks, but all the banks cycle between greater and less decentralisation – his own bank is in the process of decentralising from a more centralised model in place for the past five years. (Western Cape bank management interview)

Insurance operates on a different model reflecting the different nature of its products and its interactions with its clients. The sales force requires much less physical infrastructure support than in banking, so that there is less autonomy for divisional operations, and less decentralisation of decision-making from head office. Head office location is probably more important in this sector and the relatively strong presence of insurance head offices in the Western Cape may be a factor in the financial services sector investment performance in the province (Table 6).

<u>Occupational structure, race and gender in the labour force</u>

This section looks at the skill composition of the labour force as reflected in the occupational distribution, as well as the progress of racial and gender employment equity within the sector. Provincial data was unavailable for the sector as a whole, so that Tables 10-14 all reflect national data only. As with Table 8, they rely on SETA data and should therefore be taken as indicative: the data are compiled in part from skills development plans submitted by firms, rather than through more rigorous sampling, and are likely to reflect the position of larger firms more effectively than smaller firms.

(i) Table 10 shows the overall occupational structure for the three F&I sub-sectors, with only large insurance companies (more than 50 employees) shown due to data limitation. The large insurance companies and the banks have broadly similar structures, as would be expected. The banks employ a somewhat larger proportion of professional and technical staff because they have a larger volume of transactions. Lower-skilled employees in 'front-line contact' with customers are classified as clerical workers (such as tellers) in banking, but as sales people in insurance. Insurance agents are higher-skill employees classified as technicians and associate professionals. They fall under a new regulatory framework in the form of the Financial Advisory and Intermediary Services (FAIS) Act passed in 2003, which requires that they be accredited, and they will become increasingly professionalized in the future. The securities traders also have significant shares of professional and clerical workers, since like the banks they undertake large numbers of transactions, and also do research.[9]

The basic entry requirement for workers in the sector is matric. Sanlam reported that all its employees had attained this educational level, and the same was true for 99% of "Bank X" employees in the Western Cape. According to the latter's Western Cape retail manager, 21% of employees within the province had post-secondary qualifications which are the minimum requirement for management.

(ii) Tables 11 through 13 provide a more detailed breakdown of the racial and gender composition of the labour force in each of the three financial services branches. All three branches within financial services - banking, insurance and securities trading - have advanced Indians and 'coloureds' significantly within the top 2 occupational categories, and these groups' representation is close to or above their respective shares in the total population.[10] But Africans are severely under-represented relative to their population share in the higher occupational categories in all three branches. Africans' share of lower skill white-collar (clerical and sales) jobs in both banking and insurance has reached significant proportions, and whites are now a minority, or close to a minority, in these categories in both sectors. Coloureds fill a very large proportion of the technical and clerical jobs in insurance, well above their overall population share. This is not surprising, given the location of a large share of the workforce in the Western Cape. Since sales employees in insurance are located throughout the country, this group's proportion in this job category is much lower at 8%. Indians are strongly represented in the middle to lower white-collar occupations in both sectors. Small firms and informal workers in the insurance sector are excluded from the data here – whereas small firms such as independent brokers are likely to be largely whites at the upper end of the occupational spectrum, the informal sector – such as the 'runners' referred to above – is probably predominantly Africans in the sales category.

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[9] For the labour force analysis, the Securities category includes three sub-sectors of the 'financial and accounting services' sector as defined in the SETA framework, viz. investment trusts and company secretarial services; stockbroking; and auxiliary activities (which includes debt collecting etc). Accounting and auditing, business consulting, tax collecting and development organisations are excluded.

[10] The insurance sector data suggests that there are no Indians in the manager category, while Africans filled 13% of the positions – these are almost certainly offsetting errors, but Inseta were unable to provide the true figures.

(iii) The gender data shows that women are fairly well-represented at the top of the occupational ladder, while the clerical and service/sales categories are predominantly female as would be expected. The insurance industry seems to be lagging the other two branches somewhat in the promotion of women managers and professionals.

Access to financial services

(i) Table 14 reports Finscope data on access to banking services, for both the Western Cape and nationally. It shows that a much lower proportion of the WC population are unbanked than is the case nationally: 39.5% as against 54.6%. Less than a quarter of the WC population have never had a bank account. This is reflected in the race breakdown - the proportion of 'never banked' Africans in the province is much lower than the national average of 'never banked'. But it is alarming that while there is a relatively low share of 'coloured' people who have never had a bank account (25.6%), a very high proportion of 'coloureds' - nearly 23% of the total coloured population - have had bank accounts but no longer do.[11] This is about double the proportion of the 'previously banked' in SA as a whole.

In October 2004, the new Mzansi account was launched as an entry-level account for the unbanked population. It is based on an agreement amongst the banks to enable a low cost structure, including no monthly fees and no-cost access to holders' accounts via all ATMs. By April 2005, 827 000 Mzansi accounts had been opened, with Postbank accounting for nearly 30% of these, Standard and ABSA close to 25% each, FNB about 15% and Nedcor the remaining 7%. Ten percent of these accounts were in the Western Cape (Banking Council, 2005). These are mostly amongst the province's rural population, where the bank uses a mobile branch (Western Cape retail banking manager, Bank X, interviewed April 2005). "Bank X" claims more than twenty times as many account holders in the province for its existing entry level account as for its Mzansi accounts to date. The existing entry-level product which pre-dated Mzansi by eight years has now been pushed up to a second-level product into which the bank will 'graduate' Mzansi account-holders, and which offers services not available to Mzansi holders, such as funeral plans.

[11] 70% of the people in the WC who were 'previously banked' (15.5% of the total adult population) are 'coloured'. This is equivalent to about 325 000 people (about 10% of the adult population), which in turn is equivalent to nearly 23% of the total adult coloured population of 1.4 million.

"Bank X" estimates it has 1.13 million accounts in the Western Cape.[12] Forty-six percent of these were entry-level (Mzansi and pre-existing), and the same proportion of the total were 'regular' accounts of middle-income clients, comprising just under 10% transactional accounts and 36% checking accounts. 1.2% were upper income bracket individual accounts and the remaining 7% business accounts (85% of these being SMMEs and the others farmers and companies).

Table 14 reports on access to life insurance products amongst poor people, defined as LSM categories 1-5, people with incomes below R2195 per month. The group includes nearly 17.5 million adults, about 65% of the total adult South African population. Formal savings in these sectors of the population are very low, so that a very small proportion – 5% or less – of the population within the low income groups use life assurance and savings products such as endowments. Funeral policies and burial society membership in particular are purchased by a significantly larger share of low income people. As in banking, the insurance industry has (aside from a few companies) only begun in the past year or two to develop a more extensive range of products appropriate for poor people and to extend and adapt its product distribution models to serve low-income markets. As mentioned above, there are an estimated 50 000 'runners' - informal sales agents – in the sector, but the presence of such a large pool of *informal* labour selling corporate products at one remove, is itself an indication of the industry's limited reach into the low-income market segment. Without adequate training and customer service systems, these informal agents are limited to providing only the most basic low-risk products.

(ii) Turning to a different aspect of access to services, Table 16 reports on service provision by the four major banks in the retail market segment, together with three smaller banks (KPMG, 2004). The table shows clearly the difference in market reach between the 'big four' and the others. There has been a shift amongst the former to replace branches with ATMs over the past decade. The 2800 branches operated by the big four banks in 2003 can be compared with 3820 branches nationally in 1994, which had dropped to 3360 by 1998.[13] In contrast, Hawkins (2002) reports 7600 ATMs in all banks in 1999, implying that they had increased by at least 30% by 2003/4.[14] The major banks foresee rapid growth in electronic interaction with their customers: in early 2003, the four major banks had 825000 internet customers (5.2% of their 15.9 million retail

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[12] PWC (2003) reported only 25.7 million retail accounts nationally for the four major banks in 2002, but this figure may exclude entry-level accounts.
[13] Of course, the branches of non-big 4 banks are not included here. Data on service access points in the WC is being sought from the banks.
[14] ATMs reportedly involve costs of R200 000 each (STBT, 19/9/04).

customers) but expected the number of internet customers to double in size by 2006 (PWC, 2003). This goal may well be achieved: Standard Bank reported that its internet customer base had grown by 26% during 2004, to reach 287000 (Standard Bank, 2004). [15] The major bank interviewed has 17% of its national branch network in the Western Cape. All transactions in the province are processed locally, but business processing does not yet appear to be highly centralised, as only 7.5% of the bank's 2900 (retail division) staff are employed in call centres and telesales operations in the province.

2. Financial services structure and performance

A. The banking sector

Tables 17 through 20 chart the structure and performance of the banking sector at national level.

(i) Table 17 shows that the number of domestic banks increased steadily until 2000, but since late 2001, there has been a rapid decline, when the entire second-tier of banks collapsed, closed or were taken over in the wake of some of their excesses in the microlending market as well as difficult domestic and international economic conditions. The latter include the collapse of the dotcom boom in early 2001 followed by 'September 11' and reinforced international banks' mounting hesitancy about South Africa, so that the number of foreign banks levelled off after a steady increase post-1994. This is being reversed in 2005 with the entry of Barclays and of ICICI Bank, the largest retail bank in India, as well as possibly other foreign banks. The most important feature of this second wave of foreign entry into the domestic banking system is the foreign banks' move into the retail segment of the market, whereas during the first entry wave after 1995, they were restricted by regulation as well as market-based barriers to the wholesale corporate segments.

Table 17 also shows that growth in bank assets (15.8% *per annum)* and loans and advances (14.3% *per annum)* has been much more rapid than the 11% growth in nominal GDP over the decade. This is consistent with the relative growth rates of value added for the sector and the overall economy (Tables 1 and 2). The South African banks have regularly expressed anxiety about the impact on their own expansion of slow economic growth and intensifying competition

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[15] It was reported in early 2005 that the internet customer base in banking in South Africa was 1.5 – 2 million people (Business Report, 11/1/05). The *share* of internet-using customers will likely fall as the banks move into lower-income markets where internet access is more restricted.

from foreign bank entrants in the corporate and investment banking markets (eg. *Euromoney*, Sept 2002). Notwithstanding this, they have succeeded in maintaining high growth rates, less from entry into new markets such as the unbanked (as seen in the previous section), than from aggressive sales and distribution in already well-serviced retail markets. In addition, the major banks' domination of the retail market has enabled them to earn generous fees from services in this market segment. Fees on current accounts in SA doubled between 1999 and 2003 (BR, 31/3/05). Fees are charged on more retail products than elsewhere and fees are on average a higher proportion of transaction amounts. An international comparison of banking services costs and fees showed that SA banks charged the highest fees for a basket of services amongst a group of six countries, with the second-highest (Canada) being only 70% of the South African level (Falkena et al, 2004, chapter 8).

(ii) Table 18 shows that banking sector growth has been very profitable for both large and small banks. Recent results from some of the major banks illustrate this: Standard far exceeded its target of 10% real growth in earnings in 2004, achieving 27% (nominal) growth in its retail operations and 24% in corporate banking, while FNB increased net profit by 22%. (FM, 18/3/05; BD, 08/3/05) The big 5 banks averaged 21.3% return on equity in 2003, which is very high by international standards (Falkena et al, 2004), and can be compared with an average 14.95% return to South African banks in 1997 (IMF, 1998). The dominance of the large banks is illustrated by the fact that their average level of assets is 52 times the average level of the smaller banks in the sample. The largest foreign bank in South Africa, Citibank, had local assets which were only about 8% of the average size of the four large banks' domestic assets, and the foreign banks collectively employed only 1776 people in early 2003, equivalent to just over 6% of the 'big four' average (KPMG, 2004). The lower return on assets to the large banks compared with the small reflects the relatively higher costs of running a large banking retail network, though these costs have also been an effective barrier to entry into the retail market. Perhaps for this reason, the five major banks saw the retail sector as their most profitable, followed by the corporate, asset management and insurance segments (KPMG, 2004). Nonetheless, banks like Capitec and ABIL show that it is possible to operate second-tier banks profitably in the South African retail market.

(iii) Table 19 shows the benefits of scale to the large banks, since their operating profit per employee is high despite much higher costs. The international benchmark for cost-income ratios in banking is 60%, and this ratio is taken as an important indicator of banks' health and prospects by shareholders. Pressure on the large banks' share process have led them to lower their ratios from the mid-60% range in the late 1990s to below 60% today, and they seek further reductions. This was an important factor in branch rationalisation, but further lowering of costs will depend on increasing volumes of business to support overheads which are still high. Efficiency, as measured by cost-income ratios, is not directly correlated with size, necessarily. At end-2003, the Reserve Bank's Bank Supervision Department rated banks with assets between R5 bn and R10 bn as the most efficient group in South Africa, with a cost-income ratio of 30%, the only size group amongst South African banks with a ratio below 60% (SARB Bank Supervision Department, 2003). The large banks (assets over R100 bn) were ranked fourth of five groups with a ratio of 75%, and the least efficient were banks with assets between R1 bn and R5 bn. (SARB Bank Supervision Department, 2003).

(iv) Table 20 underlines the dominance of the four major banks together with Investec. Their combined share of total assets declined from 1994 to 2001, affected especially by the entry of foreign banks into the corporate and investment banking market segments. Since 2001, the withdrawal of both second-tier banks and cutbacks by foreign banks (see Table 17) has enabled their overall share to rise to 88.5%, exceeding the 1994 level. Between the four majors, there have been some significant shifts in this measure of market share, with ABSA declining and Nedcor and Standard increasing. The major banks' share of specific market segments, especially in the retail sector, is even greater than for total assets, though different banks dominate in different market segments, underlining Hawkins' (2002) point that competition between the banks is more intense at the product level than at firm level. The four large banks totally control the national payments system, so smaller banks wishing to enter the transmissions or credit card markets, for example, are forced to purchase access to the system from one of the four (Falkena et al., 2004). This in turn enables the large banks to reach the scale of activities required to support their infrastructure costs. The emergence of banking by cellphone and via retail distribution networks such as supermarkets could provide a (partial) alternative to the national payments system and undermine the large banks' monopoly in this respect. But the banks are already moving towards pre-empting this threat, by integrating these with their own operations, as for example in the Go-banking joint venture between Pick 'n Pay and Nedbank, and FNB's purchase of the innovative Zambian cellphone banking company, Celpay, which it likely will introduce in South Africa. Starting off a small base, the Go-banking initiative grew very rapidly, with customers rising by 23% and deposits by 25% in 2003 (STBT, 02/5/04).

These shifts are in line with the trend for South African banks and insurance companies to broaden the scope of their service offerings in line with the global shift towards “one-stop-shops” in response to increasing competitive pressures. Banks increasingly perform brokerage services for insurance companies, offer personal and corporate investment advice, and provide credit risk analysis to their clients in addition to their more traditional deposit-taking and short-term lending activities.

B. The insurance sector

Tables 21 through 25 chart the structure and performance of the insurance sector at national level.

(i) Table 21 presents the structure of the long-term (life) insurance industry, using data from the industry regulator. The regulatory framework structures the industry into six types of business, with the ‘typical’ insurers (present in all or most of the six categories) dominating industry turnover as measured by net premium income, with nearly 70% of market share.[16] Most of the remaining 30% share of the market is held by ‘linked investment’ insurers, who manage retirement funds. Most of the firms in this category are linked to parent insurance groups.[17] The ‘linked investment’ product appeared in South Africa only in the early 1990s and was intended to give investors more choice and control over the use of their retirement funds. It has rapidly gained significant market share especially from the standard life endowment products which were the staple in the South African market from the 1970s, but now appears to be a saturated market. The middle income group who were the bulk of insurance purchasers appear to have shifted away from the latter product as a result of lower than expected (or promised) returns from the investment portion of these policies.[18] Thus in addition to exercising greater control over their portfolio allocations, savers have sought lower risk investments (less volatile returns) and cheaper life insurance unbundled from investment assets.

The changing nature of consumer demand is one of several important structural shifts in the long-term insurance industry over the past decade. Table 21 shows that notwithstanding the emergence and growth of linked investment insurers, demand for insurance products overall is declining in

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[16] Net premium income is equivalent to gross premium income less reinsurance premiums.
[17] These groups’ premium income comprises mainly single-income policies with benefits which are not guaranteed, but depend on the market returns of the policy’s linked investments, which are determined by the policyholder.
[18] Fixed interest securities have performed better than the equity market over the past ten years, and within the equity market, unit trusts have underperformed relative to the market average.

the face of competition from other branches of the financial services market. Net premium income for both typical and linked investment insurers, the two dominant segments in life insurance, has declined since 2001 at an average annual rate of -3.8%. The decline in premium income has not been accompanied by similar declines in operating expenses and commissions. Costs in the insurance industry are at much lower levels than in banking, and management expenses and commissions have averaged respectively 7% and 4.2% of net premium income since 2001. But since 2001 expenses and commissions in the 'typical' insurers group have risen from 8% to 11% and from 5% to 7% of net premium income respectively.[19] As a percentage of premium income, claims also increased significantly between 2001 and 2004, from 91% to 108% for the typical insurers and 69% to 99% for linked investment companies. Together with declining premium income, this has resulted in negative operational cashflow for many companies.

The changes in economic conditions which have affected consumer demand in the industry have also created new cost pressures. In the high inflation environment which prevailed before, the steady rise of investment income and growth of new business meant that companies could afford to pay little attention to their operational costs, which consequently became bloated. However, the financial market environment has changed. On the one hand, international financial markets – a much more significant destination of South African funds than a decade ago, as a result of capital account liberalisation – have been volatile, and returns in the equity market have declined since early 2001. The JSE was part of that decline but has been in a recovery phase since early 2003. At the same time, however, inflation and interest rates in the South African economy have dropped to lower levels, so that very high nominal returns from equity investments (the largest proportion of life insurers' portfolios) have dropped markedly from their levels over 20 percent which had come to be seen as 'normal'. These changes have lowered profit margins and together with pressures from consumers about high charges, forced companies to focus more actively on the cost side in the insurance market.

(ii) These structural shifts in life insurance have had a substantial impact on the market structure in South Africa, which has also shifted in important ways. On the one hand, the market has become less concentrated at the top. Table 22 presents 2002 market shares in the life insurance market. A decade ago the two oldest and largest companies, Old Mutual and Sanlam, received

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[19] The expenses and commissions of the 'linked' insurers are very low, as they are incorporated into those of the parent group.

about two-thirds of premium income flows. (FM 08/4/05) The table shows that the top six companies, rather than only two, have 70% of market share on this measure. Old Mutual and Sanlam's combined share has dropped to about one-third, and they are no longer the market leaders in terms of new business and recurring premium income. Their historical dominance and longevity mean that together they still account for nearly 50% of the stocks of total assets and liabilities accumulated over time. In the previous era, both companies operated to some extent in protected markets where their equity holdings and 'boardroom links' underpinned sales, but over the past decade, they have been forced to dismantle these conglomerate structures. They have responded in different ways, as discussed below.

On the other hand, despite less concentration at the top end of the market and the entry of new companies into the market[20], there has been a significant – and still ongoing – process of consolidation in the sector over the past decade. Investec, the second-ranked insurer by premium income in Table 22, has disappeared from the insurance sector since 2002 (the year to which the data refers). The background to this provides insight into the fluidity and dynamic of the current consolidation occurring in the long-term insurance market. Investec had moved into the long-term insurance market only in 2001, when it took over the operations of Fedsure in which it had previously had a strategic equity stake.[21] Fedsure itself had undertaken a series of earlier acquisitions, including its mid-size competitor in the middle income market, Norwich Life, in 1998. Investec's acquisition was intended to protect its investment when Fedsure ran into difficulties, and in 2001 Investec outsourced the operation of the life business to Capital Alliance (in which it bought an equity stake), a small player in the low-income market. In 2002, Investec outsourced the operation of its (Fedsure's) pension and employee benefit business to Liberty Life. At this point, Investec's outsourced businesses were ranked 2nd (individual life) and 7th (employee benefits) in the market by premium income. In 2003, Investec sold one business to Liberty and in 2004 it sold the other to Capital Alliance, whose premium income grew 450% between 2000 and 2004 through a series of acquisitions as well as insourcing of policy administration (nine 'books' taken over since 1995) (FM, 25/6/04). At the end of 2004, Capital Alliance was bought by Liberty, making the latter the market leader in terms of premium income. Liberty plans to leverage the very efficient administrative base established by Capital Alliance (a Johannesburg-based company) to achieve cost savings in its own administration, since Capital

[20] Though not from abroad: there are apparently fewer foreign insurers than 20 years ago, at least in the retail segment. The insurance industry in South Africa differs from banking in this respect.
[21] Fedsure was the 6th largest insurance company in 1998, ranked by premium income (KPMG Report on Insurance Industry, 1998). Capital Alliance was 12th ranked in 1998, and 9th in 2003.

Alliance's administrative cost per policy is 30% below Liberty's. But it will also benefit from the insourcing expansion already planned by Capital Alliance, which claims to administer policies on average at one-third the cost in Australia and one-sixth in the UK, and it has established operations in both countries to win back-office business which will be done in South Africa (FM, 25/6/04, 10/12/04).

Further acquisitions and consolidation in the industry are very likely, as there is seen to be excess capacity in the sector, given continued competition from other financial services branches. Several large firms feel they have surplus capital available which may be used most effectively in acquisitions. Increasing competition within the industry and with other financial services has changed firms' attitude towards their capital resources, typified by the CE of Sanlam referring to the 'lazy capital' in his firm when presenting the 2004 results (STBT, 17/10/04). Industry 'CAR cover ratios'[22] have dropped significantly in recent years. In 2001, 21 typical and linked investment companies had ratios above 5 and none were below 1, but by 2004, this had shifted: only 8 companies were above 5, and 3 were less than 1. Despite this decline, there is no perception that the industry's financial strength has deteriorated, but rather that the view of what level of surplus capital is acceptable has changed, because of pressure to use available capital to increase profitability, or alternatively return it to shareholders.[23]

Given the importance of head office activities in the insurance industry, it is not surprising that the process of consolidation and rationalisation has had important implications for the Western Cape. The province has lost two of its (then) five major industry head offices since 1998. In addition to Norwich Life, the operations of Southern Life (then in the top 4 nationally) were moved to Johannesburg when the company was absorbed into Momentum, as part of Rand Merchant Bank's purchase of Anglo-American's financial sector interests in 1998. There is an interesting paradox here, in that the national accounts aggregate data reflect very fast growth in the financial services sector both nationally and in the Western Cape, yet firm-level examination of the insurance industry – ostensibly the larger of the two sub-branches in the province – indicates difficulties at the operational level, including declining market share and income from operations, even though overall income has not dropped.

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[22] This is the measure of surplus assets (not needed to fund liabilities) in terms of the minimum capital adequacy requirement defined by the regulator.
[23] Metropolitan Life returned R780m to shareholders in December 2003.

Old Mutual and Sanlam are obviously central to the trajectory of the insurance industry in the Western Cape. Given their huge accumulation of assets over past decades, both companies are in a healthy financial state with very large cash resources at their disposal, with Sanlam's soon to be boosted further by Barclays' payment for their equity stake in Absa.[24] Nonetheless, the two companies have faced rising pressures within the insurance market over recent years, and in response have adopted contrasting strategies, which are likely to have different implications for output and employment in the provincial economy. Old Mutual has taken the view that long-term growth prospects in the South African market are limited, and shifted its focus to the international market, particularly industrialised countries, and on broadening its scope from insurance to include other financial services as well. It has shifted its primary listing from the Johannesburg Stock Exchange to the London Stock Exchange, and acquired companies in the UK and the US. Notwithstanding many difficulties in establishing itself abroad, the company has persisted with its re-orientation to other economies. In its 2004 Annual Report (launched in the US not South Africa), it reported that over half of its new business in life insurance (in value terms) is outside of South Africa, as are more than three-quarters of its asset management clients. Its statement of objectives focusses not on insurance, but on the creation of an international financial services company: "our core industry is the management of money. We provide high quality investment skills to build and protect client assets." (Old Mutual, 2005) Old Mutual's operations in the Western Cape are likely to become increasingly independent of its stance towards, and fortunes in, the South African market, and linked instead to its international growth. Call centre and business information processing capacity has been expanded and upgraded to enable low-cost Rand-based service provision to its own and other insurers' foreign operations. Indeed, achieving scale economies through insourcing the administration of foreign firms was identified in 2003 as "a key element in [the] growth strategy" (Old Mutual, 2003, 47), and will of course also help to reduce domestic operating costs.[25]

Although Old Mutual's CE Jim Sutcliffe sees a strong 'home business' as essential for a good credit rating and thus a lowered cost of capital internationally (cited in STBT, 15/8/04)[26], the company's emphasis in allocating internal management and financial resources is more likely to

[24] Life insurers outside the Western Cape, including Liberty and the First Rand Group (Momentum) are also sitting on large cash piles (STBT, 06/3/05).
[25] These are above average, as are those of the other two major Western Cape insurers. See Tables 21 and 22.
[26] This comment was made shortly after Old Mutual's credit rating was downgraded by Moody's in May 2004.

be the protection of new business market share and the local asset base in South Africa, while expanding aggressively in more lucrative foreign markets. This is already the case in the US, where its 2004 sales of life insurance grew by 22% in contrast to a 5% decline in South African sales, and it is bidding to buy the largest Swedish insurer, Skandia, which has a large presence in the UK insurance market, after more than one false start in that country. By contrast, it was the last major South African life insurance company to finalise a BEE equity transaction deal, concluded only in April 2005, which affected its image and its domestic business, especially in employee benefits (FM, 28/1/05; BD, 08/3/05). However, a central feature of the deal is that the BEE partners are required to bring in new business – from the black market (implicitly) – or face financial penalties in the form of higher financing costs. It is also noteworthy that the Old Mutual BEE deal appears to be the only one in the financial services sector which includes a Western Cape empowerment group as a major partner.

Sanlam's strategy has been different on both the revenue and the cost side. It remains focussed on the domestic market as its major source of revenue growth, earning only 6.5% of its 2004 before-tax income from abroad.[27] The slogan used to encapsulate its strategy appears to be 'market segmentation' and it has re-structured accordingly. It is aggressively pursuing market share in 'new' markets, especially amongst low and middle income earners in the black population. It was one of the first financial institutions to compete its BEE equity transfer, reaching agreement on a deal for 8.2% of its equity with the Ubuntu-Botho group in April 2004, just six months after the Financial Services Charter was concluded. During 2004, it also established 52 new offices in 'underserviced' (black) areas, bought a stake in Safrican Life (the insurance arm of the Thebe Group, an early BEE player) which has a 600-strong broker network, expanded its black sales force in the middle-income market, established a new unit to focus on the low-income market (less than R10000 per month), and established a joint venture with one of the major COSATU affiliates to service union members (Sanlam, 2004). An important aspect of the effort to win market share amongst underinsured black customers, however, is increasing the company's presence in Gauteng, where a large share of the target market is based. A new unit was established to focus on employee benefits, and its head office of 500 employees set up in

[27] Sanlam has indicated it will enter foreign markets when opportunities arise, and seems particularly interested in other emerging markets, rather than industrialised economies like Old Mutual. It recently announced a joint venture in India, a very under-insured market with huge growth potential. It foresees synergies from this initiative arising from its own production expertise and its Indian partner's distribution network: an additional 'spillover' gain for Sanlam could well be distribution expertise in low-income markets.

Johannesburg rather than Cape Town. A large proportion of the newly-hired black sales agents will (presumably) be based in Johannesburg also.

On the cost side, Sanlam has been similarly aggressive. The company committed to reducing costs by R250 million during 2004 (5.2% of 2003 costs, and about 10% in real terms) and exceeded this goal by achieving nominal reductions of 5.8%. This included reducing its total staff by 1000 people (more than 10% of the 2003 figure)[28], and this is having the desired bottom-line impact. Cost-cutting has also taken the form of outsourcing administration to focus on 'core business': in 2004, the administration unit in the asset management operation – the largest third party investment administration operation in South Africa, with 15 clients managing R320 million – was sold to JPMorgan Chase, and then contracted to provide services to Sanlam. In the life office, however, Sanlam services its customers directly via a 720-seat call centre and has no plans to outsource (interview). Insourcing is done on a very small scale, with no plans to expand this activity.

The third insurance head office in the Western Cape is Metropolitan Life, which has increased market share significantly in recent years and is now rated 5th largest by premium income. Metlife has had targeted sales to black consumers for decades, and its longstanding presence in the black market is now paying dividends in the form of rapid growth of new business premiums (an increase of 38% in 2004) and increasing its share of several market segments. There is persistent speculation that it will become a takeover target for Sanlam, which has already tried once, in 2000. Should this occur, there would likely be rationalisation with consequences for employment. Metlife, which had over 3500 office employees[29], has already indicated that it does not plan to expand employment, seeking productivity gains instead (Metropolitan life, 2004).

(iii) Tables 23 and 24 provide data on the short-term insurance sector. Measured by annual national net premium income flows, the short-term insurance industry was about 20% of the size of the life insurance industry in 2004. As shown in Table 23, the regulatory framework for the industry divides short-term insurers into four groups. The largest are the 'typical' or general

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[28] Between 1995 and 2004, Sanlam's office staff complement (excluding sales agents) dropped by 31% from 12400 to 8575, of which about 7800 are in the Western Cape. This figure includes 2800 staff in the short-term insurer, Santam. In addition, at least 500 sales agents are employed in the province. Given the provincial growth rate in employment within the sector of 1.1% over the same period (Table 7), other firms have clearly been expanding their workforce, and Sanlam has dropped from 21% of the provincial financial services labour force to 13%.

[29] As well as 3650 sales employees.

insurers who have averaged 77% of market share over the past five years, and who are the primary interest from a policy perspective. 'Captive' and 'cell captive' insurers together have just under 12% of the market, having only emerged in South Africa in 1993. These are essentially self-insurance by large enterprises, which sometimes evolve into insuring in the wider market, and often get support via underwriting or reinsurance from conventional insurers. The remaining 11% of the market is held by specialised niche insurers, who insure specific risks such as transport and trucking, legal and health practices or social unrest. Property insurance comprises about 30% of the market, and motor vehicles around 35%, with the remainder mostly the specific risk categories mentioned.

Recent developments in the short-term insurance industry have been in stark contrast to that of the long-term branch. Net premium income of short-term insurers has grown by nearly 14% *per annum* since 1999, and their underwriting and investment income by 36.5% *per annum*. An upswing in the 'underwriting cycle' started in 1999, resulting from the absence of natural disasters, good climatic conditions for agriculture and reduced crime-related claims for motor vehicles and property. Since 2002, a stronger Rand has lowered replacement costs on customers' claims and there has been recovery in the equity market, both of which have strongly boosted the cyclical upswing. Since premium rates remain fixed or drop after a lag, profitability during the cycle has risen significantly, and especially since 2002. For example, claims against Santam, the industry's market leader, dropped from an average of 70% as a percentage of annual premiums between 1998 and 2002, to 61% in 2003/4, and the company's annual income before tax rose from R387 million to R1791 million in the same two sub-periods. As a percentage of premiums, underwriting profits across the industry in 2004 were at their highest levels for over 20 years.

Table 24 shows that the top five companies in the short-term insurance industry together share 44% of gross premium flows, which is a high level of concentration though less than in the long-term industry. The two largest short-term insurers are majority-owned by the two largest life insurers, Sanlam (53% of Santam) and Old Mutual (88% of Mutual & Federal). Each parent extracted a large special dividend cash payment from its subsidiary during 2004/5, benefiting from the booming short-term industry in contrast to their own faltering long-term sector. Given the favourable attitude towards economising on surplus cash within the life insurance sector, these additional resources are likely to be used either to finance further acquisitions or else to be returned to shareholders via higher dividends or equity buybacks. Neither acquisitions nor payouts to shareholders is likely to increase fixed capital formation across the economy.

Shareholders include hundreds of thousands of policyholders, who are mostly also purchasers of short-term policies who have contributed through their premiums to high profitability in the short-term sector. If the life companies do return funds to shareholders, the payments will have completed a 'circular financial flow' supporting high cost structures in the insurance industry and increasing output growth via consumption rather than investment.

The third- and fifth-ranked short-term insurers, SA Eagle and AIG, are both foreign-owned, by Swiss and US financial services groups respectively, and in general, there is a significantly higher foreign penetration in the short-term industry as compared with the long-term.[30] This may be a consequence of product brand being less important in short-term insurance than long-term, with price playing a bigger role and retention of customers a major problem. With profitability at historically high levels, there is scope for new entry into the short-term market, notwithstanding a view within the industry that the underwriting cycle peaked during 2004. The take-off during 2004 of black middle class and working class living standards should lead to expansion of the market to a new customer base, and consequent growth in employment in the sector.

In recent years the short-term insurance market saw the entry of direct insurers, based on a different distribution model than the traditional approach of decentralised and predominantly independent networks of brokers. Direct insurance uses call centres to enable direct contact between the supplier and the consumer, together with large advertising and marketing expenditures to win customer interest. The cost structures and employment implications vary significantly, the direct insurers using large-scale, low-cost labour forces of clerical workers in call centres and back offices, in contrast to the broker-driven model where costs comprise mainly commissions and administration. The direct sales model is attractive for customers already in the market who are likely to switch to a cheaper product, and their market share grew rapidly (off a very low base) from the mid-1990s. But broker and tied agent sales still comprise 95% of premiums in the South African market.

In both the short-term and the life insurance industries, 'e-business' is relatively undeveloped, in strong contrast to the banking sector. In a 2004 survey, none of 10 life insurance companies and 15 short-term insurance companies were able to accept online applications from prospective

[30] This is notwithstanding the restrictions on foreign investment in the insurance sector in South Africa, specified in its commitments in the GATS agreement of 1995. These include that most of the directors and the public officers be resident in South Africa, and 85% of the assets be held locally (Cassim & Stuart, 2004).

clients, while only 2 of the short-term companies and none of the life companies could provide an online quote to the customer. For a bare majority of companies, existing customers can view their contracts and correct details online. Broker companies were in fact further advanced in this regard, though they combined online interaction with personal contact via telephone or email. (KPMG, 2004b) The e-business component allows for scale and scope increases, as well as greater speed, all of which lower costs.

This suggests that an emerging trend may be reinforced, where companies combine the two models – some direct marketers are adding broker networks, while older companies have started using direct sales and customer service techniques. Santam, for example, has a growing customer base who approached it directly, and have increased their media expenditure to try to build brand familiarity with potential new customers (Santam, 2005). However, expansion into previously uninsured and underinsured households should further reinforce broker networks rather than telesales and call centre operations, since potential customers who are unfamiliar with insurance products are likely to prefer the more personalised service offered by brokers. One indication of this is the growth in number of informal "runners" (brokers' assistants), who are almost equivalent in size to the labour force in the formal independent broker network. Broker activities are also likely to grow in the long-term segment of the market. At the same time, the Financial Advisory and Intermediary Services (FAIS) Act passed in 2003 requires certification and accreditation of brokers in order to protect consumers – this will raise the demand for skills training initiatives.

The balance between direct sales and broker networks will have implications for the quantity and nature of future employment expansion in the short-term industry. Also impacting upon employment possibilities will be the significant international expansion upon which Santam, the only significant industry presence in the Western Cape, has embarked. Taking a contrasting view to its parent company in the life insurance market, Santam sees South Africa's growth potential as limited. It is establishing an operation in the UK and Ireland to serve the European market, and is evidently putting substantial resources into its investment as it aims to source 15-20% of its total turnover from abroad within 2 years. However, the intention is to integrate the European operations with Santam's base in the Western Cape, so that European customers will be serviced from Cape Town.

C. <u>Securities trading</u>

(i) Table 25 illustrates in broad terms the exponential growth in the JSE over the past decade. In 1992, trading volumes were 2.2 billion shares, so that they rose more than twenty-fold in the twelve years to 2004, at an annual rate of 27.4%, notwithstanding the decline in trading activity from its peak in 2001. Liquidity in the market (the value of shares traded as a proportion of market capitalisation) rose from a very low level of 5 percent in 1992 to 43 percent by 2002. In 1996, the JSE ranked 14th globally by market capitalisation. It has subsequently declined in rank in part due to the long-term depreciation of the Rand, and in part because many companies have delisted and several large corporations have transferred their primary listing abroad. Since the market was liberalised in 1995, non-resident activity has accelerated, growing by more than 20% a year, and in accounting for about one-fifth of share transactions by value in 2004. A bond market has also emerged in South Africa since the late 1980s[31], and the Bond Exchange of South Africa was formally established (with a regulatory framework) only in 1996. But trading volumes have risen to reach R8.4 billion in 2004 after peaking in 2002 at R11.7 billion. Foreign residents' transactions on the bond exchange amounted to 25% of the total in 2004. Central and local government bonds comprise over 70% of the total issued, with corporate bonds around 10%.

The growth of the financial markets has involved a rapid increase in the number of financial institutions. According to the regulator, the number of unit trust schemes rose from 168 in 1997 to 1023 in 2004, and the number of portfolio managers from 103 to 388 (Financial Services Board, 2004). The rise in 'linked investment' life insurance discussed above (Table 21) has contributed significantly to this explosion of activity, which has resulted in there being more unit trusts than the 921 companies listed on the JSE in March 2005. There has been a process of consolidation amongst unit trust managers in recent years, notably the mergers of Nedbank and BoE and of Standard and Liberty Life's investment management units into Stanlib, which had 195 000 and 600 000 clients respectively in September 2003 (FM, 05/9/03). But these mergers have been driven more by developments in other sub-sectors of financial services than by developments in the asset management and securities trading segment itself.

D. Backward linkages and cost drivers

(i) Table 26 draws on data on the Supply-Use Table (input-output) for 2000. The first column shows the spending on intermediate inputs by the financial services (F&I) sector, totalling

[31] Initially only public sector bonds were traded, and the first private corporate bond was issued only in 1992 by SA Breweries.

R11.347 bn.[32] The second column shows the proportion of financial services inputs coming from each industry, and indicates that the sector purchased only 22% of its inputs from outside the FIRE sector, and more than half (53%) from within financial services itself. Column 3 shows the total output (intermediates plus final demand) of the industries from which financial services is a significant purchaser, and column 4 shows the proportion of total output purchased by financial services. The industry buys significant shares of the output of 'other paper products' and 'published and printed products' industries' total output, as well as 'recorded media'. More detail is needed on all of these linkages, especially on the location of production in the sectors supplying significant inputs to the F&I sector, but there is likely to be some potential to encourage purchases by the sector from within the WC province.

Moving away from the aggregate figures, the process by which industry procures its inputs will be transformed over the next five to eight years by the BEE imperative expressed in the Financial Services Charter agreed in October 2003. The charter sets procurement targets of 50% of the value of all procurement from BEE accredited companies by 2008 and 70% by 2014, and financial services organisations are now beginning to restructure their procurement to meet these targets. This is likely to lead to the decentralisation of procurement away from head offices in all services segments, since black empowered firms, in many sub-sectors in manufacturing, trade and business services tend to be small or medium sized firms and relatively dispersed spatially, and so more easily accessible to local or regional procurement processes, rather than national. Thus Bank X's Western Cape retail manager interviewed for this study indicated that his organisation was shifting from procurement from large companies with a national footprint, in which the regional offices made orders but delivery and payment were via the banks' head office, to a new arrangement where procurement was more under the control of regional offices. This required a change in the bank's IT systems for tendering to enable local and regional SMEs to participate, and meant also that the bank's buying power would encourage national suppliers to form partnerships with local firms. Large capital expenditures would remain oriented towards large suppliers to enable scale economies. The new system is currently being piloted in the Western Cape. Arising from its BEE equity deal with the Ubuntu-Botho group, Sanlam has also established a set of internal structures – Provincial Advisory Boards – which will focus on supporting BEE to meet FSC targets for both sales and inputs (procurement). Since Sanlam alone

[32] Sectors which sold to the F&I sector less than 1.0% of their total output have been combined into 'all other sectors' for clarity of presentation.

spends R1.7 bn annually in procurement (Sanlam, 2004)[33], the impact of increasing the BEE profile of insurers' supplier base will be significant in the context of the October 2004 agreement on financial commitments arising from the Financial Services Charter, which specifies bank financing of black SMEs of R4 billion over five years (STBT, 10/1/04). The short-term insurance industry procures goods and services from 11 000 suppliers to meet vehicle and property claims, very few of whom are black-empowered (FM, 11/2/05). There is considerable potential for BEE in the context of widening the supplier base in relation to claims-related procurement – the market leader, Santam, for example, paid out R4 billion in claims during 2004, though procurement was only a share of this amount (Santam, 2004).

(ii) Tables 27 and 28 provide information on cost factors in the sector. Table 27 shows that the wage bill makes up about half the major banks' overall expenses, and slightly less in insurance. Computer and IT expenses are about one-sixth of non-staff costs for the banks, about R3.8 bn annually, and a slightly higher proportion for the insurance companies, totalling about R2 billion, with Old Mutual providing the bulk.[34] Firms have benefited from the strong rand since 2002, in their purchases of computer equipment and software, some of which is imported off-the-shelf systems. Marketing expenditure is also a significant share of non-staff expenditure in banking, totalling about R1.85 billion. Separate data on telecommunications costs is not available from the banks' own reports, but Table 26 suggests that communications costs (for all financial services) were over R1.5 billion in 2000, and comprised 3% of financial services' intermediate inputs. The four major banks are thought to be Telkom's largest customers (SAITIS, 1999), suggesting that telecommunications costs are an important cost driver.

Table 28 shows labour force size and the wage and salary bill for the same six financial institutions.[35] The average salary rates possibly mask large increases at the upper ends of the occupational ladder where shortages of high-skill workers have led to rapid job mobility and rising salary scales. Though two banks increased employment during 2004, overall employment declined. As already noted above, the insurance companies, and Sanlam in particular, have engaged in major cost-cutting efforts, with lower staff costs an important part of this.

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[33] Old Mutual reports procurement expenditure of R2.5 billion in 2004, of which R1.3 billion is 'influenceable' in BEE terms. The meaning of this is unclear, but the company spent R286 million (22.5% of influenceable total) with BEE firms.
[34] In the previous financial year, the banks spent R3.75 bn, 9% of operating expenses.
[35] The labour force size data in Table 28 differ from Table 22 for the two insurance companies. The labour force sizes given here are those linked to the staff expense data provided in the annual reports, preventing the deduction of some non-life insurance employment in both groups.

E. Organisation in the financial services sector

Table 29 provides a list of organisations and associations in the financial services sector, in different categories. Only one organisation, the Life Offices Association, has its head office in the Western Cape, and two other industry associations have local offices. The training institutions in banking and insurance are both present in the province.

3. Trends in the Financial Services Sector

A. International

(i) The interlinked global processes of policy deregulation and liberalisation of financial systems, on one hand, and the development of IT and telecommunications systems on the other have led to the explosion of cross-border capital flows and pressure on financial institutions to compete internationally. Global institutions based in the industrial economies have moved to offer clients a 'global package deal' including both product diversification and a wider geographical spread of operations (Dicken 1998, p. 393), which has produced a significant trend to consolidation in the financial services industry, both across borders within market segments (banking, insurance, securities trading) and across segments. Competitive pressures have led to the adoption of new technology to improve margins, but the high fixed costs of the latter have had to be spread over an ever-growing customer base to maintain profitability. Repeated waves of mergers and acquisitions have inevitably resulted. As the customer base has grown and become more diverse, the relative power of shareholders has increased, further accelerating moves to consolidation in order to save costs, though there is little evidence that cost savings are a consistent outcome of consolidation.

(ii) Over the past two decades, an important bifurcation has emerged in the global financial markets. On one hand, the corporate markets – for wholesale banking, investment banking, and money and foreign exchange trading – have become international. But on the other hand, retail banking – for consumer and small business deposits and loans – as well as insurance, remain domestic (Group of Ten, 2001). This bifurcation has manifested itself in South Africa as well, as mentioned earlier. Retail banking and life insurance have seen very limited entry by foreign institutions until the current Barclays takeover of Absa, which, significantly, is an acquisition rather than a greenfield entry. At the international level, the corporate/retail bifurcation has led to three important trends which are relevant over the medium-term horizon.

(iii) The first trend involves the increased risk in the macroeconomic environment, resulting in part from the internationalisation of the corporate financial markets together with the liberalisation of the foreign exchange and money markets and the financial engineering and new technologies which have resulted (such as derivatives). Business cycles internationally are now accompanied by greater volatility in asset prices, because of the threat of contagion from one economy to others. This increases financial fragility, as in 2001, when the collapse of the dotcom boom and September 11 suddenly ratcheted up the pressure on profitability in the global financial services industry, and major international banks were forced to look for fresh capital, increase loan loss provisions, manage risk more tightly and cut costs. The impact spread throughout banks' global network, including into small markets such as South Africa. This was one of the major reasons for the withdrawal or downscaling of their South African operations after 2001 of many of the foreign banks which had entered South Africa during the late 1990s (Gelb & Black, 2004).

Today, the global economy faces a major threat to its stability, which is expressed as exchange rate misalignment between the US dollar and the Chinese yuan. The underlying problem is deeper however. On the one hand, the relative strength of the dollar against the yuan masks not only dollar weakness against other currencies. But equally important, the dollar/yuan rate reflects an interdependency of China and the US which may not be sustainable. On the one hand, the rate supports strong Chinese imports to the US (and elsewhere) while also enabling Chinese portfolio investment into the US to make possible low interest rates which underpin US growth. But on the other hand, the surge of Chinese imports is affecting US and European production levels while raising the weight of dollar-denominated assets in China's financial system to excessive levels. The US administration is actively pressing China to move to a more flexible foreign exchange regime, which would lead to its currency strengthening and reduce its exports. But too rapid a rise in the yuan (and fall in the dollar) could precipitate an outflow of Chinese and other Asian financial investment from the US, with potentially disastrous consequences for the US and Chinese economies, and for the world economy more broadly, particularly given already slowing growth in other major economies, especially Europe. The Chinese financial system is not regarded as yet ready to support an open capital account, which a flexible currency requires. For South Africa, this scenario poses two major threats – a possible collapse of commodity prices due to much lower demand, which would affect export revenues and the current account balance, and a possible outflow of funds from merging markets, which would further tighten the pressures on the balance of payments.

(iv) The second trend is that increased risks have resulted in a global effort to improve regulation and transparency of information, which has produced the Basel II accord on capital adequacy, as well as new accounting standards (AC133). Basel II replaces Basel I which was introduced in the 1970s. It extends the Basel I definition of risk to include operation and market risks, adding these to credit risk (the only one included in Basel I) to take account of new risk-management instruments such as derivatives which had not evolved when Basel I was formulated. Basel II rests on a three-tiered approach: banks are required to self-regulate their risk by distinguishing borrowers into different 'risk classes' and holding more capital for borrowers in riskier classes; they are subject to supervisory review by the official national supervisory and regulatory authority; and they are subject to market discipline through requirements for transparency, involving the publication and disclosure of information. Smaller banks will be able to use external agencies' credit ratings to assess borrowers, but larger banks will be expected to develop their own internal ratings systems. In other words, Basel II will require banks to spend large amounts improving their risk management systems, and require governments to undertake significant improvements in national supervisory and regulatory regimes. South Africa already has all the necessary legislation in place for Basel II (SA Reserve Bank, 2004). But the banks are from ready for the implementation which is scheduled for January 2008: the five major banks (including Investec) have implemented '60-85%' of what is required, but the smaller local banks have barely begun the process (KPMG, 2004).[36] As other financial (and even non-financial) institutions begin to engage in banking or quasi-banking activities, they will also become subject to Basel II requirements.

There are several issues of concern about Basel II's impact, which apply to most emerging markets, including South Africa (Nitsure, 2005). First, the cost of implementation to the banking institutions is very high, both financially and with respect to scarce skills, and this will have an opportunity cost in terms of other priorities for the financial sector, including implementing the Financial Sector Charter. Early estimates of the cost of developing Basel II systems suggested the South African banks would have to spend R1 billion. Developing the risk assessment systems

[36] The foreign banks present in South Africa were rated as only 60% ready.

required by Basel II requires the development of new IT systems which have driven up expenditure on this item. Possibly more intractable problems are the shortage of risk analysis personnel with the requisite skills and the lack of historical data on which to base models. Second, it is expected that Basel II will raise the cost of capital, and this is especially true for small borrowers. The Basel II committee has accepted a slight relaxation of the capital adequacy requirements for loans to SMEs, but the latter are defined in industrialised country terms, as borrowers with turnover of less than 50 million euros (Griffith-Jones et al, n.d.). As a consequence, all emerging market borrowers, whether private or public entities, can expect higher borrowing costs. Thirdly, the system is expected to enhance the 'pro-cyclicality' of credit extension and thereby deepen recessions. When banks' non-performing loans ratio rise in a downturn and their capital base declines, the risk measurement, models will require them to hold more capital against remaining loans and hence force them to cut new lending. This will contribute to further lowering economic activity and is also likely to force more borrowers into bankruptcy which might have been avoided. Fourth, in relation to South Africa specifically, the contractionary impact of Basel II on credit extension and economic activity more broadly may be exacerbated by the very cautious and conservative approach of both the authorities and the five major banks, who are maintaining capital adequacy ratios well above those required by the new system. For example, although Basel II's requirement is 8% of capital against loans as against Basel I's 10%, the Reserve Bank has decided to stick to the higher level, notwithstanding the extra room the lower ration would give for 'development lending'. In fact, the overall capital adequacy ratio of the South African banking system was 12.6% in November 2003 and rose to 13.2% in November 2004. The four major banks have all endorsed this approach as 'prudent' arguing that it will enable them to improve their risk management (BR, 08/2/05). In the US, only the large banks are being forced to comply fully with Basel II. The South African approach may be in part a reaction to the emphasis on BEE throughout the economy, which means that an increasing number of transactions are likely to involve risk assessment on different criteria than Basel II .

(v) The third trend is the effort to extend and protect openness in financial services by incorporating it into GATS, the General Agreement on Trade in Services, which is part of the Doha round of WTO negotiations. South Africa has received 'requests' (demands) from the US and the EU in relation to financial services, as well as from several smaller countries.[37] The US

[37] Summaries of the requests to and offers by South Africa can be found in Cassim & Stuart (2004).

and EU demands focus on easing restrictions for foreign institutions to operate in both banking and insurance sectors in South Africa (commercial presence, or Mode 3 in GATS-speak) in particular by allowing branches to be established more easily making use of the parent company's capital base. At present, independently-capitalised subsidiaries are in effect imposed on foreign entrants. The US is also demanding an end to the four major domestic bank's *de facto* control over the national payments system, and opening up the asset management segment to international competition. Both seek a rollback of remaining foreign exchange controls to enable foreign institutions to access the domestic market without establishing an operation in South Africa, that is, through modes 1 and 2, cross-border trade and consumption abroad. Finally and perhaps significantly, both requests identify cross-border trade in financial information as a concern, suggesting that there is interest in using South Africa as a base for back-office operations and business processing.

The next round of ministerial discussions on the Doha process is scheduled for Hong Kong in November 2005. This means that GATS discussions should be ratcheting up before then, but it appears that the South African offers on GATS (in response to the requests) have not yet been tabled. The reason for the delay is unclear but it is possible that the final South African negotiating position is not yet agreed, in the complex set of trade-offs between the trade negotiators and the various domestic regulators whose support for the GATS approach is required, including the Bank Supervision Department of the Reserve Bank and the Financial Services Board, as well as regulators in the other service sectors. Close observers of the WTO feel that the GATS process is likely to proceed very slowly compared with other WTO processes, so that further liberalisation of financial services in the wake of GATS may be several years off.

(vi) In the financial services sector, the GATS process is closely linked to the spread of e-business, a fourth international trend which may lead to the breakdown, or at least a shift, of the corporate/retail bifurcation discussed above. This is one factor behind the pressure from the US and Europe to open up South African financial markets to their asset managers for cross-border trade (GATS mode 1), as well as the inclusion of financial information in their GATS requests. Based on a survey of 43 global financial institutions, Deloitte's expects $400 billion of outsourcing business to be moved offshore by the top 100 institutions until 2010, with savings expected to be $150 billion (Deloitte, 2004). Several companies in South Africa, both local and foreign and in different segments of the financial services sector, are positioning themselves to win a share of this business: examples mentioned above include Capital Alliance (now within

Liberty Life) in life assurance, Santam in short-term insurance and JPMorgan Chase in asset management.

B. South African trends and issues

(i) A number of trends in the domestic financial services sector have already been discussed above, in the context of the distinct trajectories of the various sub-sectors in terms of recent growth record and competitive structure. Banking has grown significantly faster than GDP as a whole enabling banks to earn good returns on equity and protecting the dominance of the four major institutions. Many small banks died in the effort of winning market share, and the survivors probably benefited from their peers' demise. In life assurance, income growth has been in decline, and as in banking the difficulties for medium and small institutions in gaining market share have lead to the hollowing out of the 'second tier' through acquisitions and absorption into large companies, though there is more contestability amongst the latter. Short-term insurance has enjoyed a very favourable operating environment, leading to rapid growth and entry by new firms. Securities trading and asset management have had spectacular growth rates despite equity market volatility, so there has been little consolidation independently of new relationships amongst parent firms. The major domestic financial services groups are present in all or most of the market segments, so that they are hedged against difficulties in any single segment.

Over the next five to ten years, the structure of South African financial services will be impacted upon by three interrelated issues which are likely to change the structure of the sector. These are the BEE process linked to the Financial Services Charter; regulatory and market-driven processes to enhance competition in the sector and in retail banking in particular; and the impact on operational structure and labour demand as the boundaries between the different segments of financial services in South Africa shift and blur.

(ii) The Financial Services Charter (FSC) was agreed in October 2003 as a voluntary and self-enforced mechanism, involving audited reports but no penalties, except the loss of contracts if BEE requirements of customers (private and public sector) are unmet. Table 30 presents the Charter's BEE targets in its six dimensions: human resource development (employment equity and skills), procurement and enterprise development, access to financial services (including 2 points for consumer education), empowerment financing (including targeted investments and BEE transactions), ownership and control and corporate social investment. Leaving aside the last of these, the impact of the BEE target in each dimension will depend on the dynamics of the market in which the intervention occurs.

In relation to the labour market, Tables 11 to 13 show that the 2008 targets for black senior and middle level managers (20% and 30% of all management respectively) have been met or nearly met on average in all three branches of the sector, though representation of *Africans* at these levels remains rather poor. Meeting the gender targets (only one-fifth of the employment equity target of 15 points) is likely to prove more difficult, however. Sustaining the targets over time may prove more difficult however, as firms hire from a restricted labour pool, which is likely to exacerbate skills shortages at the senior levels within the sector and impact negatively on staff costs. Depending on the sector's growth as well as skilled labour supply dynamics more generally, the FSC may well create pressure towards flatter organisational structures and scale-based service models with fewer managers. The FSC includes 5 points for firms' contribution to skills development amongst black employees, but the potential for a worsening skills shortage goes wider than this, and we will return to this below.

Turning to procurement and enterprise development, financial institutions are much further from the 2008 target (50% of procurement from BEE companies). Old Mutual for example, reported 22.5% for 2004, and Sanlam reported not its performance to date but rather its approach to future procurement. As noted above, however, their approach, like that of Bank X, is likely to accelerate enterprise development on a strongly decentralised basis, and financial institutions' buying power has the potential to have a very significant impact on the emergence of a class of small and medium black entrepreneurs in the future. But as with high-skill employees, there may be negative cost implications for the financial sector in the short- to medium-term.

All the major financial services groups have concluded equity deals with empowerment consortia which mean they will meet their ownership and control targets. Looking beyond the headlines, the real importance of these deals, as implied above, is the extent to which they promote the transformation of procurement, staffing and financial provision, for example building new black broker networks in both branches of the insurance industry or ensuring credit flows to black enterprises in other sectors. In regard to the latter, the Charter includes, since October 2004, a set of specific commitments for empowerment financing, which amount to the provision of R122.5 billion over a five-year period. Of this amount, 41% (R50 billion) will go to BEE 'transaction financing' (ownership and control deals, not necessarily within the financial sector), and 34% and

20% respectively to finance housing development and infrastructure in low-income areas (R42 billion and R25 billion). Presumably much of the housing and infrastructure funds will go to black-empowered firms, but the major beneficiaries are likely to be formerly white corporations which have brought in black partners, rather than firms operated by black entrepreneurs. This leaves only 5% (R5.5 billion over five years) of the overall amount for financing black-owned production enterprises in industry and agriculture, equivalent to only 3-4 % of the amount spent by the four major banks and two insurance firms on procurement (Table 27).

On an annual flow basis, this level of empowerment financing is equivalent to about 2.5% of the stock of total loans and advances in the banking sector (Table 17), though the empowerment flow includes not only the banking sector but also insurance and securities trading. It is therefore likely to be a significant share of annual financing flows within the economy (assuming the commitment is met), which has raised concerns about the impact of BEE on risk assessment models and Basel II implementation, as well as on overall credit extension in the economy.

The last dimension of the FSC is broadening access to financial services. The impact of this issue as a growth driver in the domestic financial services market over the next decade will vary substantially between in insurance and banking. At present, the latter has a higher level of service to the poor (Tables 14 and 15) and has implemented the rollout of the Mzansi account, while the insurance industry is yet to specify its FSC targets in the area of access. However, market forces in the life insurance industry particularly – stagnation in 'traditional' domestic markets, falling aggregate incomes and more intense competition – are likely to lead to the acceleration of entry into the low income market by large companies as a major source of new sales. In contrast, the initial rapid takeup of the Mzansi account can be expected to level off, after which expansion of banking services to the unbanked will depend in large measure on the emergence of more active competition in domestic retail banking. When the Mzansi account was initiated, the major banks decided to implement a common pricing structure as well as share their ATM infrastructure and other services. They were compelled by the Minister of Finance (the *de facto* competition authority in the banking sector) to eschew this price agreement and adopt a more competitive approach to the process.[38]

[38] A case may have been made for direct regulation of prices in this situation.

(iii) Turning to competition in retail banking, there is a need for more competition to lower costs and broaden product offerings throughout the consumer, but particularly in the low income segment, notwithstanding the Mzansi initiative. The Treasury report on competition in banking emphasised the low degree of contestability and restricted choice at that end of the market (Falkena et al, 2004). It argued that the high cost of providing entry-level services in banking combined with low or even negative returns on low-income earners' savings accounts discourages institutional entry. Three processes could enhance competition in future.

The first is foreign entry into the sector. The first wave of foreign entry between 1995 and 2000 was focussed on the wholesale banking market, and was linked to a range of factors: the highly developed financial and physical infrastructure, the substantial equity market (by developing country standards), the country's economic dominance in sub-Saharan Africa enabling it to be a base for wider operations, and the prospect of major privatisation and empowerment deals (much of which has not occurred). Disappointing returns to foreign banks together with the international financial downturn from 2001 ended that wave of entry, but the process is now resuming. there is much hope that Barclays' entry into the top four retail banks in South Africa will increase contestability within this group. As with many foreign investors, it is assumed that Barclays will bring higher productivity into the domestic market through more efficient technologies, and that it will pass costs savings on to consumers in an effort to increase market share. There appears to be little, if any, evidence that Barclays is indeed more efficient than domestic banks (by no means certain), or that it would pass on any efficiency gains in lower charges, or that it is more interested in growing its market share amongst the entry-level customers (Absa already has about 25% of the Mzansi account-holders). Since Barclays paid a high price for Absa (R82.50 per share, more than 33% higher than the price of R60 when it first made its offer), it may well prioritise strong short-term returns in the protected high-income market, rather than to try to win market share through aggressive price-cutting in the entry level market where profitability is lower. This is particularly true since it will want to support its share price in the London market, where there is some scepticism about the Absa acquisition. Government approval of the deal was conditional on Absa management continuing to be South African, and the existing management will remain unchanged[39], suggesting also continuity in strategy and approach. Finally, both parties have made it clear that a major motive for the deal was expansion in Africa (where

[39] Though job cuts within Absa are expected.

Barclays' subsidiaries will be transferred to Absa), rather than expansion into new segements of the South African domestic market.

Entry by banks from other emerging and middle-income countries could have more significant long-run consequences for low-income competition as compared with UK banks.[40] The Indian bank ICICI entered South Africa early in 2005, and has clearly signalled its interest in the low-income retail market by initiating an "exchange of ideas and areas of co-operation" with several local banks focussed on that market segment (BD, 22/3/05). ICICI started as a publicly-owned development finance institution in 1955, and began a commercial banking operation in 1994. It now has 10-million customers in India, where it emphasises use of ATMs, call centres and the internet, with only 20% of transactions though its 500 branches. This seems similar to Abil in South Africa, though of course ICICI is many times larger.

A second process driving retail banking competition is the spread of banking services to non-banks, especially retail chains (supermarkets, furniture dealers) and cellphone operators, who already have the infrastructure networks and the back office support systems in place. The main target of non-bank entrants is lower-middle and lower-income earners (up to R20 000 per month). As noted, the major banks are addressing this competitive threat by moving into partnerships with non-bank entities to internalise the alternative channel. The banks' control over the payments system provides a strong incentive for a non-bank entity to enter a partnership agreement.

One reason the major banks are moving quickly to form partnerships with non-bank service providers looking to expand into banking, is that at present the latter have no alternative to such partnerships since they are outside the financial service regulatory framework. This may soon change, as in a third process to promote competition, government is extending the legislative framework of the banking system to enable easier entry into deposit-taking activities. Two bills have been formulated for discussion in parliament later in 2005, one enabling private institutions to take savings deposits and make loans[41], that is, to operate as 'narrow' or 'core' banks, and the other enabling member-based organisations to offer its members deposit-taking, loan and payments services. While government expects the new entrants to include retailers and cellphone

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[40] Standard Chartered, which like Barclays disinvested in the 1980s, has also re-entered the South African retail market by acquiring the internet-based 20Twenty bank, and there are persistent rumours that it will offer to purchase FirstRand.
[41] Those institutions which both take savings deposits and make loans will be 2nd-tier 'core' institutions and those only taking savings will be 3rd-tier 'narrow' banks.

companies, these may prefer to partner with established (1^{st}-tier) banks, as non-regulatory barriers to entry will remain high.[42] At the same time as introducing this enabling legislation, government is also legislating a new consumer protection framework in financial services, including the introduction of a deposit insurance scheme and a national credit bill, which aims to prevent a repetition of the micro-lending crisis which helped precipitate the collapse of second-tier banks in 2001/2. This may lead unintentionally to a rise in the cost of borrowing to consumers by imposing common procedures on all lenders.

(iv) The fourth trend is a growing shift towards a new distribution and service model in financial services, both banking and insurance, which combines a much more diverse range of sales activities with the centralisation of business operations. In banking, this is driven by an increased focus on transactions volumes and scope to promote fee-based revenues alongside traditional interest-based income, in which branches are seen as sales points where the institution can make contact with customers. The decline in branch numbers may be reversing as the major banks begin to see their branches as sales and service channels to interact with customers, both entry-level customers as well as higher-income customers whose banking and financial services needs are more complex. In both groups there is a desire for greater information and understanding of their options and the costs and benefits involved, so that personal service is preferred. For the banks, this is more likely to increase fee-based revenues. As a result, closer linkages between branches and banks' electronic networks (ATMs, internet, cell-phone activity) are likely (STBT, 25/04/04). This will change branch functions and staffing size and composition, as 'back-office' operations are centralised rather than remaining at branch level. ABIL Bank, which focuses on the low-income rural market, is perhaps a pointer to the future, as it has built a network of 400 branches, but 25% of its 3000 staff are employed in a call-centre (STBT, 16/05/04). In addition, Postbank, which now targets primarily the low-income market and adopted the Mzansi account as its major product, was reported in 2003 to be planning to establish a network of 3000 ATMs through its post office branch network (Hawkins, 2003).

In insurance, centralisation is driven by efforts to enter new consumer markets and the stronger (FAIS Act) regulation, together with the pressure to lower administrative costs to impove profitability in a declining market. The former has encouraged distribution methods such as worksite marketing and bancassurance, and the latter an emphasis on tied agents rather than

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[42] Insurers with no links with banks may also see this as an opportunity to move into the sector, and reduce their costs of premium collection.

independent broker networks. At the same time, the strong linkages between banks and insurance companies in South Africa have meant bancassurance continues to grow. In both branches, there has been significant scale-based centralisation of administrative operations and after-sales services, separate from sales activity itself by branches or brokers.

The common theme in these shifts is the increasing complementarity between direct personal service and electronic provision, rather than their being (understood as) substitutes. This has significant implications for skills requirements and labour organisation and is likely to continue under the impetus of the FSC, as noted earlier. The senior 'Bank X' manager interviewed argued that the complexity of management tasks and roles within banking had increased significantly, due to the shift from 'traditional banking' towards a wider range of financial services and the changing nature of South African society – even branch managers needed not simply standard banking knowledge as in the past, but a wider knowledge of financial services, more generic sales and marketing skills, as well as more specific skills in areas such as IT and human resource management. He suggested that existing institutions and courses which service the banking sector's training needs do not provide the type of training needed for bank management today. Notwithstanding this concern, his bank spends two-thirds of its training expenditure in the Western Cape on managerial and professional staff (11% of employees), with the senior staff getting externally-provided training in contrast to the clerical and sales staff, about half of whom go through internal short courses each year. The banker interviewed indicated that shortages were largely on the business banking side rather than the retail side. In contrast, senior insurance staff get far less training than their banking counterparts: although 43% of external training expenditure was spent on managers and professionals (16% of employees) by one of the two major insurers in the province, this was only 7.5% of total training expenditure, since almost all expenditure was internal, and on technical service and sales workers.[43] This company reported shortages amongst senior managers and professionals as well as amongst associate professionals, especially financial advisors who are now subject to FAIS requirements. Companies' requirements for black advisors who have the cultural knowledge and language skills to engage with a growing black customer base also aggravates the skills shortage.

(v) The fifth trend is the outward expansion of banks and insurance companies, into the rest of Africa and beyond. All four major banks are actively involved in a range of sub-Saharan African

[43] Only 8% of this company's total training costs are paid to external providers. Training expenditure information could not be obtained from the other large insurer.

countries, though Absa (now boosted by Barclays' strong presence across the continent) and Standard are at the forefront, in terms of the number of countries where there is a presence. In life insurance, Sanlam, Metlife and Liberty (essentially coat-tailing Standard) have a growing presence in Southern Africa.[44] The base of African operations remains very small in both banking and insurance as Table 31 illustrates, but with higher returns on equity in the rest of Africa than in South Africa itself, earnings growth is very rapid. As a result, growing shares of financial investment and human resources are likely to go into expanding operations in Africa. At the same time, operational services in many On the other hand, much of the service provision for these operations takes place from South Africa, in areas such as IT, account administration, and marketing, so that the demand for these will expand.

[44] Momentum (which apparently has no presence in Africa of its own) has an effective stake of 34% in African Life, which has operations in Botswana, Namibia, Kenya, Ghana, Zambia and Tanzania. It has probably the largest scope of the South African life insurers in Africa, though its operation is not the largest in value terms.

Tables

Table 1: Financial services in the Western Cape, Shares of GDPR

	Basic prices (Rm, 2000 prices)		Sectoral shares (% of GDPR)			
Year	**GDPR**	**F&I**	**F&I**	**Primary**	**Secondary**	**Tertiary**
1995	103,112	11,488	11.1	6	27.2	66.8
1996	106,930	12,844	12.0	5.9	26.2	67.8
1997	109,634	12,988	11.8	5.8	26.4	67.8
1998	109,405	12,821	11.7	5.6	26.1	68.3
1999	113,978	13,449	11.8	5.7	25.4	68.9
2000	119,098	14,105	11.8	5.3	25.6	69.1
2001	124,047	16,231	13.1	5.1	24.6	70.3
2002	129,187	17,318	13.4	5.3	24.7	70.0
2003	133,508	18,470	13.8	4.7	23.7	71.5
Average			*12.3*	*5.5*	*25.6*	*69*
Growth % p.a.	*3.3*	*6.11*	*6.11*	*0.3*	*1.5*	*4.2*

Source: StatsSA PO441 Third Quarter 2004 Table 17, and data supplied by Quantec Research
Note: "F&I" throughout refers to Financial intermediation and Insurance, as a sub-sector of Financial intermediation, Insurance, real Estate and Business services, which is referred to below as "FIRE".

Table 2: Financial services in the Western Cape versus South Africa, Contributions to GDP (Basic prices, Rm, 2000)

Year	**SA F&I**		**WC F&I**		**WC F&I as a share of SA F&I (%)**
	Rm	**% GDP**	**Rm**	**% GDPR**	
1995	48,450	6.7	11,488	11.1	23.7
1996	54,416	7.2	12,844	12.0	23.6
1997	58,145	7.5	12,988	11.8	22.3
1998	57,898	7.4	12,821	11.7	22.1
1999	65,165	8.1	13,449	11.8	20.6
2000	68,648	8.2	14,105	11.8	20.5
2001	77,354	9.0	16,231	13.1	21.0
2002	83,764	9.4	17,318	13.4	20.7
2003	89,245	9.7	18,470	13.8	20.7
Average		*8.1*		*12.3*	*21.7*
Growth % p.a.	*7.9*		*6.1*		

Source: StatsSA PO441 Third Quarter 2004 Tables 10 & 17, and data supplied by Quantec Research (2005)

Table 3: SA and WC FIRE, sub-sectoral percentage shares (constant 2000 prices)

Year	South Africa			Western Cape	
	Finance and Insurance	**Real Estate**	**Business Services**	**Finance and Insurance**	**Real Estate & Business Services**
1995	38.5	41.5	20.7	44.0	56.0
1996	40.5	39.6	20.2	46.2	53.8
1997	41.3	38.5	20.3	45.2	54.8
1998	40.2	36.7	23.1	45.2	54.8
1999	43.0	34.5	22.4	44.6	55.4
2000	43.9	33.1	23.0	45.0	55.0
2001	45.8	30.6	23.6	47.1	52.9
2002	46.6	29.6	23.8	47.7	52.3
2003	47.7	28.2	24.1	48.1	51.9
Average	43.1	34.7	22.4	45.9	54.1
Growth % p.a	7.93	0.1	7.1	6.11	3.97

Source: StatsSA PO441 Third Quarter 2004, and data supplied by Quantec Research (2005)

Table 4: Gross Value Added and its distribution, 2000

	FI	**Total economy**
% of Gross output		
Intermediates	38.5	50
Value added	61.5	50
% of GVA		
Wages &Salaries	38.1	52.6
Taxes	2.9	2.5
GOS	59.1	44.9
GVA % gross output	61.5	50

Source: StatsSA, Supply and Use Tables, 2000
Note: Based on GDP data before November 2004 revision

Table 5: Financial Services in South Africa, Gross Fixed Capital Formation

	Basic Rm, 2000 Prices		Shares of F&I GFCF (%)			FIRE GFCF as % total SA GFCF	F&I GFCF as % total SA GFCF	F&I GFCF as % FIRE GFCF	F&I GFCF as % F&I value-added
	FIRE	F&I	Buildings	Machinery & Equipment	Transport Equipment				
1995	23,717	7,787	52.7	18.6	28.6	19.7	6.5	32.8	16.1
1996	26,301	8,524	51.7	21.0	27.3	20.1	6.5	32.4	15.7
1997	29,111	10,394	48.8	22.1	29.1	21.0	7.5	35.7	17.9
1998	28,300	9,352	45.4	23.9	30.7	19.5	6.5	33.0	16.2
1999	25,388	9,728	45.0	24.5	30.4	19.0	7.3	38.3	14.9
2000	27,347	10,246	45.8	25.5	28.8	19.6	7.3	37.5	14.9
2001	27,744	10,415	45.9	27.6	26.5	19.2	7.2	37.5	13.5
2002	28,802	10,430	47.5	28.0	24.4	19.2	7.0	36.2	12.5
2003	29,585	11,185	50.2	28.3	21.5	18.1	6.8	37.8	12.5
2004	33,279	12,675	54.3	27.0	18.7	n.a.	7.1	38.1	n.a.
Average %			48.7	24.7	26.6	19.5	7.0	35.9	14.9

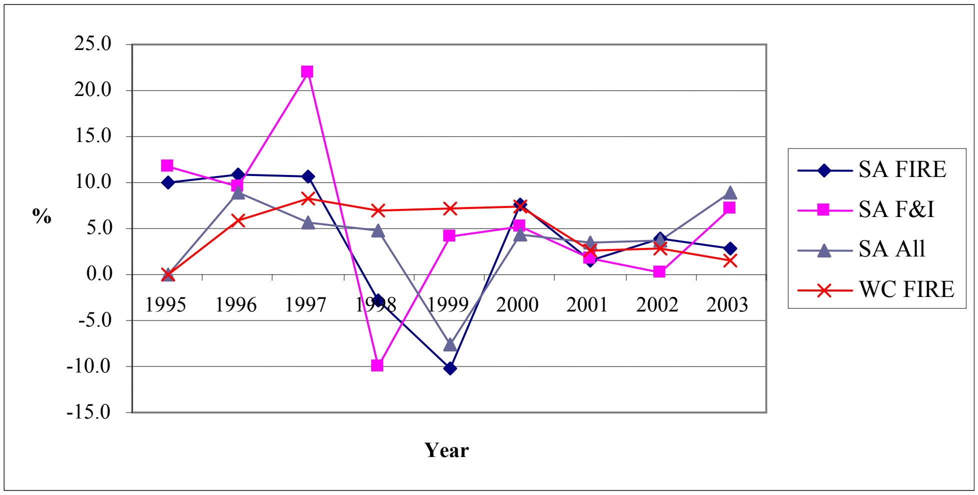
Source: Based on data supplied by Quantec Research (2005)
Note: FIRE and F&I GFCF for South Africa net of transfer costs.

Table 6: FIRE in the Western Cape, Gross Fixed Capital Formation

	FIRE GFCF (Rm, const 2000 prices)	FIRE as % WC GFCF	WC FIRE GFCF as % SA FIRE GFCF	WC FIRE GFCF as % WC FIRE value added
1995	5,714	30.8	24.1	21.9
1996	6,044	31.1	23.0	21.7
1997	6,543	32.2	22.5	22.8
1998	7,003	33.1	24.7	24.7
1999	7,511	33.9	29.6	24.9
2000	8,065	33.9	29.5	25.7
2001	8,268	33.1	29.8	24.0
2002	8,507	33.6	29.5	23.4
2003	8,639	32.7	29.2	22.5
Average %		32.71	26.88	23.5

Source: Based on data supplied by Quantec Research (2005)
Note: GFCF data for Western Cape only available for FIRE sector, not for F&I. Asset breakdown not available for FIRE.
FIRE and F&I GFCF for Western Cape and South Africa net of transfer costs.

Figure 1: Gross Fixed Capital Formation, Year-on-year percentage changes, 1995-2003



Source: Based on data supplied by Quantec Research (2005)

Table 7: F&I Employment in Western Cape

Year	F& I	WC F&I as % WC Formal Employment	WC F&I as % SA F&I	Sectoral shares (%) of Western Cape Employment including informal employment			
				F&I	Primary	Secondary	Tertiary
1995	59,778	4.5	20.4	4.2	14.5	19.5	58.3
1996	64,465	4.8	20.2	4.4	14.2	19.4	58.2
1997	67,125	5.0	20.0	4.6	14.0	18.1	59.2
1998	68,255	5.2	19.8	4.7	13.9	17.0	59.8
1999	65,691	5.0	19.6	4.5	13.7	16.5	59.8
2000	64,598	5.0	19.4	4.5	13.6	16.0	60.0
2001	64,922	5.1	19.1	4.5	13.4	15.2	60.8
2002	64,001	4.9	18.9	4.4	12.7	14.8	61.7
2003	65,270	5.0	18.6	4.5	12.4	14.4	62.0
Average		5.0	19.6	4.5	13.6	16.8	60.0
Growth % p.a.	1.1			1.1	-1.8	-3.5	0.9

Source: Based on data supplied by Quantec Research (2005)

Table 8: Provincial Distribution of Employees

Province	Banking	Insurance[1]	Securities Trading[2]	Total[3]
WC	19,493	36,720	7,351	63,564
Gauteng	79,228	43,200	22,175	144,603
KZN	16,470	9,720	2,457	28,647
Other provinces	24,763	18,360	4,230	47,353
SA Total	139,954	108,000	36,213	284,167
WC % of national employment	13.9	34.0	20.3	22.4
Employment in top group of firms[4]	116,201	28,412	n.a	
Concentration of Employment in Top 5 SA Firms (%)	83.0	39%[5]	n.a	

Source: Bankseta SSP 2003; Inseta SSP 2005-2009; HSRC *Report to Fasset 2002* Appendix B; companies' annual reports 2004

Notes: 1. The insurance sector data do not capture a "large proportion" of the estimated 52000 independent financial advisors, who do not work for large insurance companies. Those excluded work as independent self-employed brokers, rather than for broking companies. Thus the total of 108 000 is an underestimate for formal employment in the sector. This total also excludes all informal employment, including an estimated 50000 'runners' who sell policies informally on behalf of established companies (Inseta SSP 2005-9, p 5).

2. Securities Trading includes only investment trusts, stockbroking firms and auxiliary financial intermediation services, as defined by FASSET.

3. The scope of the financial services sector as defined here is not necessarily the same as in StatsSA & Quantec data.

4. This refers to the top five in banking, and the top four in life assurance, where Investec is excluded from the latter.

5. This figure is the proportion of the top four companies employment in the total of 72326 people who, according to Inseta, are employed in large firms in the sector (with more than 50 employees).

Table 9: Provincial Distribution of financial institutions

Province	Bank head offices	Foreign Bank Branches	Foreign Bank Rep Offices	Insurers head offices	Securities trading*
Western Cape	1	0	1	10	26
Gauteng	16	14	38	53	69
KwaZulu Natal	4	1	0	6	11
Other 6 Provinces	2	0	0	0	6
National	23	15	39	69	112

Source: SARB, Bank Supervision Department Annual Report 2003, www.loa.co.za , www.saia.co.za, www.jse.co.za (9 May 2005)
Notes: * Brokerages listed by the JSE - head offices and branches counted separately.

Table 10: Occupational Distribution (% by sub-sector): Finance & insurance

Occupational level	Banking	Large Insurers*	Finance & Accounting Services Sector **	Total Financial Sector
Managers/Owner Managers	8	8.6	14	9.1
Professionals	10	8.3	21	11.2
Technicians/Assoc Prof	22	21.6	10	20.1
Clerical/admin	51	31.9	42	43.9
Sales & related	6	25	12	12.7
Other	3	4.6	0	3.0
Total	100	100	100	100
Size of labour force ('000)	140.0	91.9	36.2	268.1

Source: Bankseta SSP 2003; Inseta SSP 2005-2009; HSRC *Report to Fasset 2002* Appendix B
Note: *Occupational breakdown only available for large insurers (more than 50 employees). Employment total: PWC 2004
** The total labour force in the Finance and Accounting Services Sector, as defined by the SETA, is 92,323. Of this figure, 36,213 are employed in investment entities and trusts, stockbroking and auxiliary financial services, the three sub-branches included in the financial services sector (Table 8). The remaining 56,110 are in accounting services, business consulting, tax collecting and development organisations. The occupational breakdown was only available for the entire labour force of 92,323.

Table 11: Occupational distribution by race and gender (%): Banking Sector

Occupational level	African	Coloured	Indian	White	Total	Male	Female	Total
Managers/Owner Managers	6.3	2.6	4.4	86.8	100	75.8	24.2	8
Professionals	9.9	5.1	7.1	77.9	100	61.6	38.4	10
Technicians/Assoc Prof	16.4	13.1	11.5	59	100	34.1	65.9	22
Clerical/Admin	25.9	12.9	10	51.3	100	26.9	73.1	51
Service/sales	42.9	16.5	10.2	30.4	100	45.9	54.1	6
Manual labour/other	78.6	12.2	1.6	7.6	100	63.6	36.4	3
Total	23.2	11.5	9.3	56	100	38.3	61.7	100

Source: Bankseta SSP 2003

Table 12: Occupational Distribution by race and gender (%): Large Insurers (Total Employees 91882)

Occupational level	African	Coloured	Indian	White	Total	Male	Female	Total
Managers/Owner Managers	13.4	6.7	0.0	79.9	100	80.6	19.4	8.6
Professionals	7.0	12.0	12.0	69.0	100	69.7	30.3	8.3
Technicians/Assoc Prof	23.9	18.5	9.3	48.3	100	59.1	40.9	21.6
Clerical/Admin	29.0	22.7	8.9	39.3	100	38.2	61.8	31.9
Service/sales	35.7	8.0	8.7	47.7	100	69.7	30.3	25.0
Manual labour/other	43.7	34.5	0.0	21.8	100	63.3	36.7	4.6
Total	27.1	16.4	8.0	48.5	100	58.0	42.0	100

Source: Inseta SSP2005-2009, based on 2004 research. Employment total: PWC 2004.
Note: Occupational breakdown by race and gender only available for large insurance companies (more than 50 employees).

Table 13: Occupational distribution by race and gender (%): Securities

Occupational level / Sub-Sector	African	Coloured	Indian	White	Total	Male	Female
Managers/Owner Managers							
Investment Entities and Trusts	11.5	4.2	10	74.3	100	70.4	29.6
Stock Broking and Financial Markets	6.2	8.6	4	81.1	100	72.7	27.2
Auxiliary Activities	9.1	5	3.1	82.8	100	60.9	39.1
Professionals							
Investment Entities and Trusts	10.2	2.8	13.1	73.9	100	57.5	42.5
Stock Broking and Financial Markets*	8.4	26.9	4.5	60.1	100	40.5	59.5
Auxiliary Activities	34.8	4.4	1.6	59.2	100	60.9	39.1

Source: Fasset Draft SSP 2005-2009
Note: Absolute numbers were not available for the sub-branches, therefore averages for the securities trading branch could not be calculated.
* The racial and gender distribution here is possibly an error, as the Fasset report suggests 20% of the professionals in this category are coloured women.

Table 14: Access to banking, percentages

	Currently banked	Previously banked	Never banked
Western Cape			
Black	55.8	10	34.2
White	86.7	8.1	5.2
Coloured	51.5	22.9	25.6
Asian	93.4	0.7	6
LSM 1-5	40.5	15.4	44.1
Total population	60.5	15.5	24
South Africa			
Total population	45.5	12.3	42.3
% of banking access category who are:	**Western Cape**		
Black	29	20.2	44.9
Coloured	40.3	69.9	50.4
White + Asian	30.7	9.9	4.7
	South Africa		
Black	64	83	89
Coloured	8	13	9
White + Asian	28	4	2

Source: FinScope 2004

Table 15: Access to Insurance Products in LSM 1-5

LSM	LSM1-5 2003 Actual Usage %	Estimated Total Number of Clients in LSM1-5 ('000)
Funeral	8.4	1,462
Life Assurance	4.6	796
Endowment	1.7	404
Pension	5.3	917
Provident Fund	4.8	833
Burial Society Membership	29.8	5,200

Source: FinMark Trust (2004)
Note: LSM 1-5 includes 17.453m people earning less than R2,195/month, and comprising 65% of total adult population.

Table 16: Banking sector, Service Delivery

2003	ABSA	FNB	Nedcor	Standard	Capitec	ABIL	Teba	Total
Branches & Services Outlets	659	642	775	708	266	400	96	3546
ATM's	3311	2103	1288	3097	58	n.a.	37	9894
Point of Sale Devices	24600	26710	14232	26000	n.a.	n.a.	n.a.	91542

Source: Genesis, 2003; KPMG, South Africa Banking Survey 2004

Table 17: Growth of the South African Banking Industry

Year	Domestic Banks	Foreign Banks	Total Assets (Rb)	Loans & advances (Rb)	% Growth in Assets	% Growth in loans & advances	% Growth in Nominal GDP	Total Assets as % of GDP	Loans & Adv'ces as % of GDP	Nominal GDP (Rb)
1994	35	6	344.1	272.1	-	-	13.1	71.4	56.4	482.1
1995	37	4	398.7	313.7	15.9	15.3	13.7	72.7	57.2	548.1
1996	39	6	471.3	376.2	18.2	19.9	12.7	76.3	60.9	618.0
1997	40	9	549.6	436.5	16.6	16.0	11.0	80.1	63.7	685.7
1998	39	12	653.7	503.1	19.0	15.2	8.3	88.1	67.8	742.4
1999	41	12	726.1	551.5	11.1	9.6	9.6	89.2	67.8	813.7
2000	44	15	821.0	613.0	13.1	11.2	13.3	89	66.5	922.1
2001	39	15	1,050.1	740.6	27.9	20.8	10.6	102.9	72.6	1020.0
2002	28	14	1,102.9	824.8	5.0	11.4	14.2	94.7	70.8	1,164.9
2003	23	15	1,381.5	912.0	25.3	10.6	7.4	110.4	72.9	1,251.5
2004	16	21	1,498.2	1,036.8	8.5	13.7	9.8	109	75.4	1,374.5
Growth p.a. 1994-2004			15.8	14.3						11.0

Source: Falkena et al (2004); SARB Quarterly Bulletins, www. resbank..co.za

Table 18: Banking Sector Performance and Size, 2003

	Return on Equity (%)	Return on Assets (%)	Effective tax rate (%)	Total South African Assets (Rm)	Employees in South Africa
Top 4 Banks					
Absa	21.4	1.4	24.0	358,721	32075
FirstRand	22.5	1.3	29.0	231,224	23716
Nedcor	0.4	0.0	55.0	234,960	23120
Standard	24.0	1.6	31.4	327,860	28228
Unweighted Average	*17.1*	*1.1*	*34.9*	*288,191*	*26785*
Selected other domestic banks*					
Investec	17.3	0.8	-5.1	71,221	2935
ABIL**	23.2	8.9	34.4	7,024	3029
Capitec	7.2	7.2	36.2	434	1180
Imperial	2.1	2.1	-2.6	12,955	566
Teba Bank	3.5	3.5	29.9	1,583	612
Unweighted Average***	*9.00*	*5.43*	*24.48*	*5,499*	*1347*

Source: KPMG Banking Survey 2003, 2004.
Note: * Several domestic banks did not provide data.
**2002 figures.
*** These averages exclude Investec.

Table 19: Banking Sector Efficiency, 2003

	Operating Expenditure /Total Assets (%)	Cost to income ratio (%)	R' 000 per employee	
			Operating Profit before tax	Operating Cost
Top 5 Banks				
Absa	5.0	60.0	141.1	1784.8
FirstRand	3.3	57.0	218.7	365.5
Investec	2.7	72.0	4312.0	1225.0
Nedcor	3.3	70.1	44.0	427.0
Standard	3.6	57.0	252.4	388.4
Unweighted Average	*3.58*	*63.22*	164.05***	741.43***
Other domestic banks*				
ABIL**	16.4	36.6	n.a.	n.a.
Capitec	57.7	75.3	40.0	206.0
Imperial	2.5	44.2	377.2	475.5
Teba	14.0	63.3	124.8	349.4
Unweighted Average	*22.65*	*54.85*	*180.67*	*343.63*

Source: KPMG Banking Survey 2004
Note: *Several domestic banks did not provide data
** 2002 data

Table 20: Market Share: Banking Industry Assets

% of total banking sector assets	1994	1998	2001	2002	2003	2004	Mortgage loans	Advances	Credit cards
ABSA	29	23	19.3	20.6	18.9	19.7	30	21	25
Standard Bank	21	19.5	17.6	19.6	23	25.7	23	20	29
Nedcor	15	15.7	13.8	14.6	20.3	20.6	23	20	19
First Rand Bank	19	14.4	18.7	19.3	18.5	17.6	15	19	23
Investec	3	5.1	6	5.8	6.1	4.8	4	6	3
Other Banks	13	22.3	24.6	20.1	13.2	11.5	5	14	1
Total	100	100	100	100	100	100	100	100	100

Source: Hawkins (2003); SARB Bank Supervision Department, Annual Report 2003; SARB DI900 returns, various years

Table 21: Long Term Insurance Industry 2001-2004

	Number of companies 2004	2004 Net Premiums	% of Total Net Premiums	Annual growth rate of net premiums 2001- 4	Average 2001-2004			
					As % of Net Premiums			Growth rate: number of policies
					Management Expenses	Commission	Claims	
Typical Insurers	43	108,256	69.0	-3.5	9.5	6.0	99.5	5.0
Link Investment Insurers	13	43,942	28.0	-4.9	1.0	0.0	88.3	25.5
Niche Insurers	2	488	0.3	-40.6	12.3	15.5	75.5	93.0
Cell Captive Insurers	7	1,211	0.8	55.5	42.0	3.3	43.8	n.a
Reinsurers	7	2,462	1.6	17.2	8.0	18.3	65.0	n.a
Assistance Insurers*	6	474	0.3	20.2	22.3	10.0	65.5	13.8
Total Market**	78	156,833	100	-3.8	6.9	4.2	94.4	10.6

Source: FSB, Annual Report 2004; Special Report on the Results of the Long Term Insurance Industry December 2004
Note: * Assistance Insurers offer life policies where sum assured does not exceed R10,000.
** Weighted averages.

Table 22: Market Share: Long Term Insurance sector (2002)

	As % of SA total			As % of net premiums		% Growth in Number of Policies	Employees in South Africa
	Gross Premiums	Total Assets	Total Liabilities	Management Expenses	Commissions		
Old Mutual	19.5	30.7	29.3	8.6	4.15	0.1	13,480[4]
Investec	13.5	1.9	2.1	0.2	0.1	230.3	n.a
Sanlam	12.8	18.8	18.2	9.5	5.1	-4.7	7,660
Momentum Group	9.1	11.1	12.2	5.2	3.74	-2.7	2,000[5]
Liberty Group	8.1	10.2	10.1	8.3	9.3	3.3	5,272
Investment Solutions	6.9	5.6	6.2	2.3	0.24	26.9	218
% Share of Top 6	69.9	72.66	71.87				
Average of Top 6[2]				6.0	3.7	46.3	
Metropolitan (ranked 8th)	3.5	27.9	24.4	12.4	6.1	-6.7	7,229
% Share/average of WC-based [3]	35.70	77.4	71.9	9.3	4.7	-2.3	47.63
Total SA[1] (R bn)	177.39	761.06	691.77				55,022

Source: PWC (2004), p68; company interviews and annual reports.
Note:
1. Includes all participants in PWC (2004).
2. Averages are weighted by market share of gross premiums, except for employment average.
3. WC-based includes Sanlam, Old Mutual and Metropolitan Life.
4. Old Mutual life business employees in South Africa.
5. Approximate number provided by company.
6. Average labour force of top 6 excluding Investec.

Table 23: Short Term Insurance Market by Segment, 1999-2004

Rm	General Segment		Cell Captive Segment		Captive Segment		Niche Insurers		Total Short Term Market	
	Net Premiums	Under-writing and Investment Income	Net Premiums	Under-writing and Investment Income	Net Premiums	Under-writing and Investment Income	Net Premiums	Under-writing and Investment Income	Net Premiums	Under-writing and Investment Income
1999	12,673	908	1,582	323	305	87	2,457	1,425	17,017	2,743
2000	13,044	1,395	1,422	88	527	101	2,336	589	17,329	2,173
2001	14,497	1,961	1,608	226	596	180	1,812	657	18,513	3,024
2002	16,860	1,714	1,868	77	698	204	2,195	438	21,621	2,433
2003	19,774	2,554	2,773	240	308	227	2,047	652	24,902	3,673
2004	24,211	4,303	3,486	506	214	176	2,808	1,067	30,719	6,052
% growth p.a.	*13.8*	*36.5*	*17.1*	*9.4*	*-6.8*	*15.1*	*2.7*	*-5.6*	*12.5*	*17.1*
% avge share	*77.4*		*9.6*		*2.2*		*10.9*		*100*	

Source: FSB Special Report on the Results of the Short Term Insurance Industry, December 2004

Table 24: Short Term Insurance: Market Share, Gross premiums, 2002

	As % of SA total	
	Gross Premiums Written	**Assets less Liabilities**
Top 5		
Santam	17.6	15.6
Mutual & Federal	11.3	14.0
SA Eagle	6.3	3.6
Hollard	5.5	4.0
AIG	3.3	0.4
Market Share of Top 5 (%)	**44.0**	**37.7**
Other Western Cape-based Insurers		
Monarch	0.8	0.3
MUA	0.4	n.a
Total South Africa (Rbn)	38.20	16.34

Source: PWC (2004), FSB Annual Report 2002

Table 25: Securities Trading: Growth of JSE Equities Market, 1995-2004

	Turnover*		Market Capitalisation ($ m)	Share transactions by non-residents ($ m)	
	Value (R m)	Volume (million shares)		Purchases	Sales
1995	63,247	5,148	277,390	6,554	5,248
1996	117,099	8,993	241,571	8,877	7,754
1997	206,542	17,850	230,040	16,196	10,859
1998	319,334	34,412	168,536	18,858	11,742
1999	448,381	43,097	259,739	23,136	16,611
2000	536,877	49,566	204,301	20,779	18,485
2001	606,136	59,557	147,472	17,247	14,762
2002	808,662	55,790	181,998	23,754	24,392
2003	752,249	43,053	260,748	24,237	24,300
2004	1,031,207	45,438	442,520	38,553	32,885
Annual growth %	36.4	27.4	5.3	21.8	22.6

Source: www.resbank.co.za,www.jse.co.za
Notes: * Turnover figures include off-order book trades.

Table 26: Backward linkages with other sectors

Use of products	Purchases by F&I	% of F&I inputs	Total industry output	% total industry output purchased by F&I
	Rm		Rm	
Paper products	239	0.5	15,440	1.5
Other paper products	668	1.3	5,516	12.1
Published/printed products	2,942	5.7	15,351	19.2
Recorded media products	83	0.2	1,479	5.6
Optical instruments	392	0.8	14,341	2.7
Furniture	145	0.3	14,608	1.0
Electricity	545	1.1	31,193	1.7
Water	164	0.3	10,350	1.6
Trade services	586	1.1	28,762	2.0
Transport services	934	1.8	82,108	1.1
Communications	1,562	3.0	57,343	2.7
Health and social work	472	0.9	32,789	1.4
All other sectors	2614	5.1	1,348,669	0.2
Sub-total	*11,347*	*22.1*	*1,657,947*	*2.8*
FSIM	3,963	7.7	26,533	14.9
Financial services	27,273	53.1	101,252	26.9
Real estate services	3,463	6.7	86,191	4.0
Other business services	5,320	10.4	54,338	9.8
All FIRE	*40,020*	*77.9*	*268,314*	*14.9*
Total uses at purchasers' prices	**51,368**	**100**	**1,926,261**	**2.7**

Compensation of employees	31,163	38.0	424,958	7.3
Other taxes less subsidies	2,352	3.0	20,189	
Gross operating surplus	48,381	59.0	363,094	13.3
Total gross value added / GDP	**81,896**		**808,241**	**10.1**
Total supply of intermediates (all industries)			**808,735**	
Total output at basic prices	**133,264**		**1,616,976**	**8.2**
Imports			229,740	
Taxes less subsidies			79,815	
Total supply at purchasers' prices			**1,926,261**	

Source: StatsSA (2003b), Supply and Use Tables, 2000.
Note: FSIM refers to "Financial Services indirectly measured", that is, the imputed income received by banks and other financial institutions as a result of the margin between their lending and borrowing rates. "Financial services" refers to other income received by financial institutions, in the form of fees for services.

Table 27: Contribution to Operating Costs, % shares of total

	ABSA	Nedbank	Standard	FNB	Top 4 banks	Old Mutual	Sanlam	Top 2 Insurers
Staff costs	49.8	48.5	55.8	51.5	51.8	45.2	56.6	48.2
Computer Equipment & IT	7.6	11.2	8.1	6.1	8.3	12.9	7.0	11.4
Marketing	3.6	4.5	3.5	4.3	3.9	n.a	1.1	n.a.
Total operating costs (Rm)	10,287	11,041	15,242	9,537	46,107	13,144	4,633	17,777

Source: Companies' annual reports, 2004, except FNB, 2003. Averages are weighted.

Table 28: Employment ('000), total annual & average monthly staff costs (Rand), South Africa

	2004			Change in 2004	
	Domestic Employment ('000)	Total wage & salary bill (Rm p.a.)	Cost per employee (R'000/month)	Employment	Total wage & salary bill
Absa	31.7	4821	12.7	-2.2	7.1
First Rand Bank	32.7	5274	13.4	1.9	7.4
Nedbank	21.1	5350	21.1	-12.8	8.1
Standard Bank	28.1	5929	17.6	1.5	19.3
Average*/Total - Top 4 Banks	*113.6*	*5323*	*15.7*	*-2.1*	*10.1*
Old Mutual**	20.2	5941	24.5	-1.2	-2.8
Sanlam	8.6	2624	25.5	-10.4	-1.0
Average*/Total - Top 2 Insurers	*28.8*	*4951*	*24.8*	*-3.9*	*-2.3*

Source: Company Annual Reports 2004
Notes: * Averages are weighted by size of labour force.
** Old Mutual figures exclude Nedbank employees. Foreign employees and costs could not be separated out.

Table 29: Financial Sector Industrial Bodies

Industry Associations	Offices in Western Cape
Association of Collective Investments	1
Banking Council of South Africa	0
Board of Healthcare Funders	0
Institute of Pension & Provident Fund Trustees	1
Life Offices Association	Head Office
Micro Lenders Association	0
SA Insurers Association	0
Regulators	
Financial Services Board (FSB)	0
Micro Finance Regulatory Council	0
Training	
Institute of Bankers	1
Insurance Institute of South Africa	1
Operational Issues within sector	
Back Office Forum of South Africa	n.a
South African Back Office Treasury Forum	n.a
Trade Unions/Professional Associations	
Association of Black Securities & Investment Professionals (ABSIP)	0
Financial Intermediaries Federation of South Africa	0
Institute of Retirement Funds	0
Insurance and Banking Staff Association	0
Insurance Brokers Council	1
South African Black Insurance Brokers Association	0
South African Society of Banking Officials - The Finance Union	0
The Financial Planning Institute of South Africa (previously ILPA)	0

Source: Bankseta SSP 2003, Inseta SSP 2005-2009, Fasset SSP 2005-2009

Table 30: Financial Sector Charter, Scorecard weights allocation

BEE Component	Points allocation
Human resource development	20
Of which: Employment equity	15
Skills development	5
Procurement & enterprise development	15
Access to financial services	18
Empowerment financing	22
Of which: Targeted investments	17
BEE transaction financing	5
Ownership & control	22
Corporate social investment	3
Total	**100**

Source: Financial Sector Charter (2004)

Table 31: Banking & insurance: Major corporations' presence in Africa

%	Share of earnings in Rest of Africa	
	2003	**2004**
ABSA	2.6	1.7
FNB	7.6	5.4
Nedcor*	360	3.4
Standard	7.8	8.3
Investec	n.a.	n.a.
Old Mutual**	3.7	2.9
Sanlam***	1.3	3.1
Momentum	0	0
Liberty	n.a.	n.a.
Metlife	0.8	9.4

Source: Annual reports. Investec, Liberty and Momentum provided no breakdown.
Note: * In 2003, Nedcor earned R198m in Africa, while total earnings were R55m due to losses in South Africa and other operations. Its total earnings in 2004 were R1447m, of which R49m were from Africa outside SA.
** Old Mutual's average includes earnings from all non-SA and non-US operations, that is, UK, Africa and Far East.
*** Sanlam did not provide an earnings breakdown – the table presents the share of 'embedded value' (a stock, rather than a flow) in the African operations.

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BR, Business Report

FM, Financial Mail

STBT, Sunday Times Business Times

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ABSA

First National Group

Investec

Metropolitan Life

Nedcor

Old Mutual

Sanlam

Santam

Standard Bank Group

Online databases

Johannesburg Stock Exchange, www.jse.co.za

South African Reserve Bank, www.resbank.co.za

Statistics SA, www.statssa.gov.za

Contact details for Western Cape offices of associations and institutes in financial services

Association of Collective Investments

Facilitates growth and development of the collective investment industry

Tel: 021-794-0175

Website: www.aci.co.za

Institute of Pension and Provident Fund Trustees

Run by Lexus nexus Butterworths Publishers/Pensions world magazine

Pierre Reinecke 021-910-0452

Tel: 021-555-8900

Website: www.pensionsworld.co.za

Life Offices Association

A forum to promote the interests of the long-term insurance industry and its stakeholders.

Tel: 021-421-2586

Website: www.loa.co.za

Institute of Bankers

Provides education to the industry

Tel: 021-685-0023

Website: www.iob.co.za

Insurance Institute of South Africa

Delivers contemporary education and skills development in the insurance industry

Tel: 021-418-3767

Website: www.iob.co.za

Insurance Brokers Council

A national organization to act collectively on behalf of independent brokers

Tel: 021-665-0085

Website: www.ibcsa.org.za