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Innovation in the SA payments landscape: Can the banks respond?

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The payments sector in South Africa is undergoing rapid transformation, driven by digital innovation, regulatory reform, and shifting consumer behavior. Fuelled in part by the global push to reduce cash usage and improve financial inclusion, South Africa's National Payment System (NPS) is evolving to become faster, safer, and more accessible. The South African Reserve Bank's 'Vision 2025' provides a roadmap for modernising the NPS, encouraging instant digital transactions and greater interoperability. At the same time, both traditional banks and agile fintech companies are competing to capture market share in an increasingly complex and competitive ecosystem.

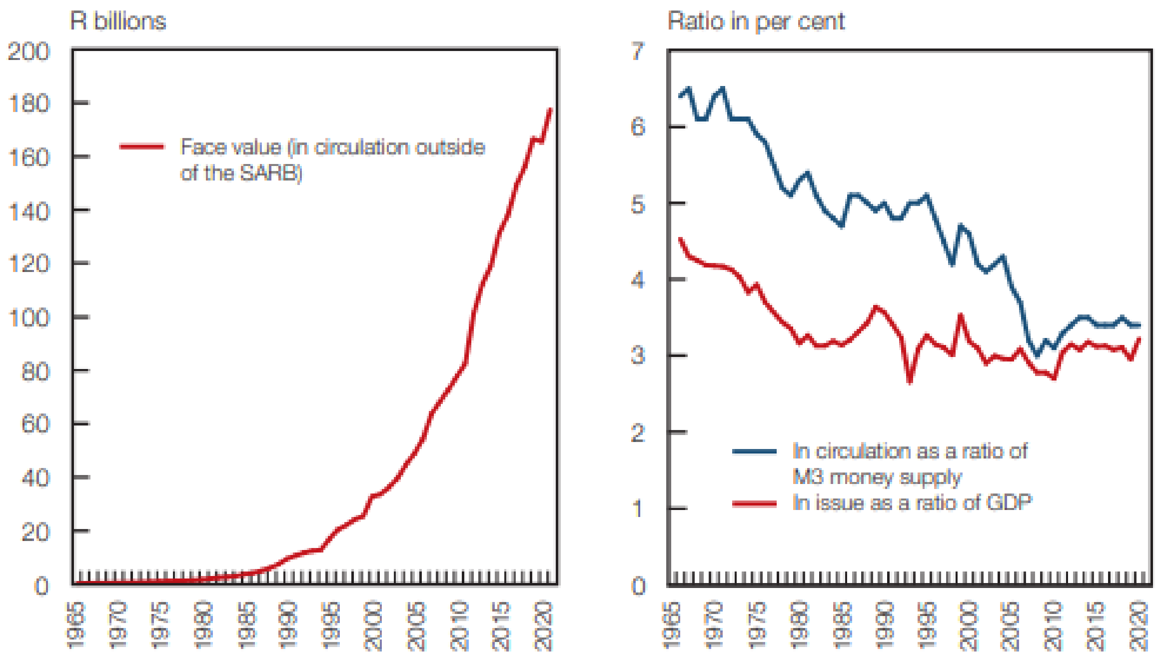
This article explores the progress made so far, and whether traditional banks can adapt quickly enough to remain relevant, or if they will be disrupted by more agile players.

Innovation in the global payments landscape has accelerated rapidly in recent years.

Underlying this is the desire of countries to reduce cash in circulation – particularly through government-backed programs to improve payments systems. Removing cash can help improve financial stability and increase transparency (helping reduce tax evasion) and it is also very expensive to handle given the security risk, particularly in SA.

Encouragingly, data from the South African Reserve Bank (SARB) highlights good success in reducing cash in circulation as a percentage of GDP. But the SARB would like to reduce this further. Figure 1 depicts how the value of cash in circulation has risen in absolute value in SA but as a percentage of GDP it has declined.

Figure 1: Banknotes and coins in circulation



Source: SARB

The SARB is focused on modernising South Africa's payment system.

Vision 2025, released by the SARB in 2018, outlines a strategic roadmap for modernising the NPS to support economic growth and financial inclusion. Aligned with the country's broader development goals, the strategic framework focuses on nine key goals, including improved regulation, transparency, innovation, competition, interoperability, and financial inclusion—all aimed at boosting economic activity and benefiting all South Africans.

Good progress has been made in achieving Vision 2025, particularly with the launch of PayShap.

PayShap is a digital payments service that allows one to send and receive instant payments at a fraction of the cost of real time EFT payments. The technological innovation behind PayShap - built using distributed ledger technology - has provided an opportunity for agile banks to capitalise on using these cheaper payment rails (e.g. Capitec). However, the uptake from a consumer point of view has been slow when compared to that of PIX and UPI (Brazil and India's instant payment platforms), and banks like Capitec are expecting the government to encourage the use of PayShap.

While the development of PayShap is highly commendable, it is apparent that there is more work to be done in other areas of Vision 2025 with improving interoperability among different payment systems being one example. The SARB defines interoperability as a technical or legal compatibility that 'allows participants within different systems to clear and settle payments or financial transactions across systems without participating in multiple systems'.

However, companies are reluctant to participate in interoperable systems.

In practice, companies are incentivised to retain customers in their own ecosystems, providing a one stop shop for consumers where they can handle their daily financial services related needs in a super app. This is because the interoperable alternatives can lead to money exiting their ecosystem, thus negatively affecting the internal velocity of money and therefore, revenue generation opportunities.

The proliferation of innovation in this space and high levels of engagement with banking and payment apps has highlighted the importance of building an ecosystem with the intention of capturing a larger share of a consumer's 'wallet' or spend. In one survey (What is Financial Wellness?) it was found that in the US, 45% of respondents performed a finance-related task on a mobile app at least once a day. The two most popular tasks were mobile banking (37% of respondents) and payments (32% of respondents). This level of engagement has expedited the innovation in financial technology.

In many of these apps one can transact, make payments, send money, pay bills, buy insurance, access loans or savings products, earn rewards or purchase goods and services at various partner shops. Non-banks have often used app wallets with payment channels as an entry point to this market before offering other financial service products. In theory, this poses a threat to the banks especially if customers choose to handle their financial affairs using non-bank offerings. However, the banks have been very proactive in building very modern digital offerings that compete directly with nimble non-bank companies (as we will highlight later).

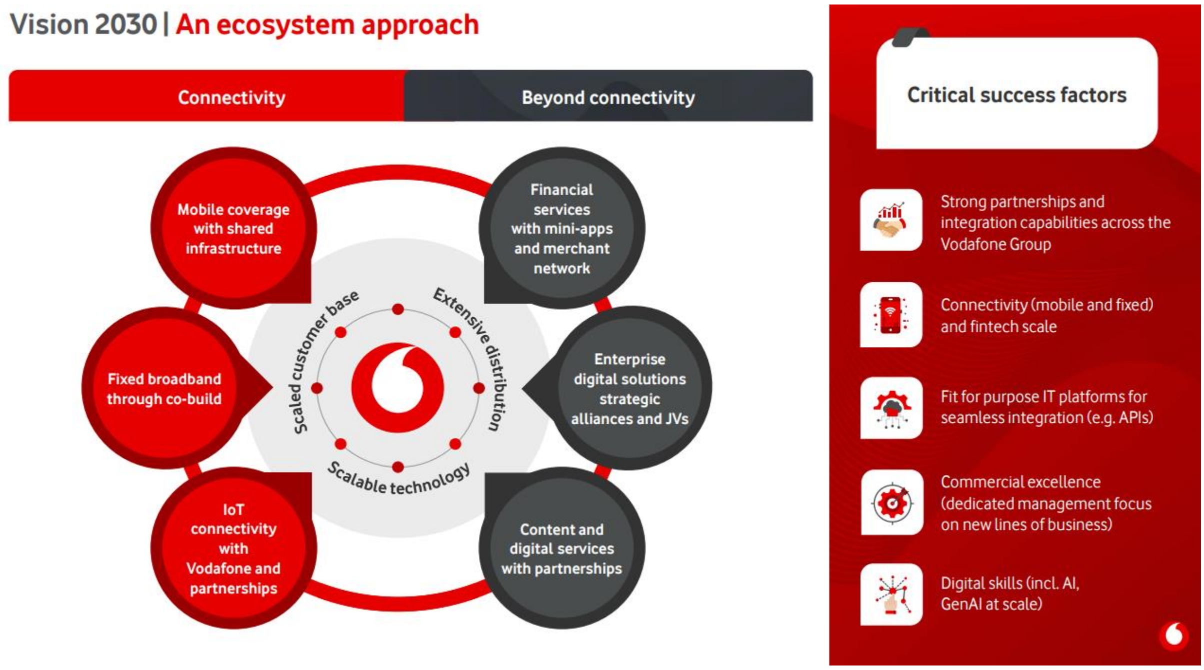
Innovation in digital financial services has helped drive sustainable growth in some companies (e.g. Capitec) or helped them diversify away from declining revenue streams (e.g. Vodacom). This highlights that one doesn't always need to search outside of SA for exciting investment opportunities.

Vodacom: a non-bank innovating in payments

Vodacom, traditionally a mobile communications company, has built a financial service offering (powered by Alipay) to leverage its global user base of 210 million customers. It now boasts 85 million fintech customers and believes it can grow this to 120 million by FY30. This has been especially relevant given the success of M-Pesa in Kenya, where Vodacom has exposure through its ownership in Safaricom. Financial services now make up 11% of group service revenue and it makes up 43% of Safaricom service revenue. The fintech platform registers roughly US$1.2bn in mobile money transaction value per day. Investment in its Vodabucks rewards program has improved the customer experience and achieved better customer loyalty. The evolution of Vodapay now means customers can shop at various partners through the app whilst also using their mobile wallets to send and withdraw money as well as make payments, pay bills, access insurance products and obviously buy airtime and data. MTN has also built a similar offering with MoMo app.

The slide below shows Vodacom's strategy around building a customer-centric ecosystem that links mobile connectivity with other product channels such as financial services. The financial services part of the business has better growth dynamics than the traditional mobile services revenue streams, hence Vodacom placing a lot of importance on execution here.

Figure 2: Vodacom's customer-centric ecosystem



Source: Vodacom Investor relations website

Vodacom has achieved exciting milestones in its fintech journey but now faces formidable competition in its core business from mobile virtual network operators (MVNOs) as well as its fintech division.

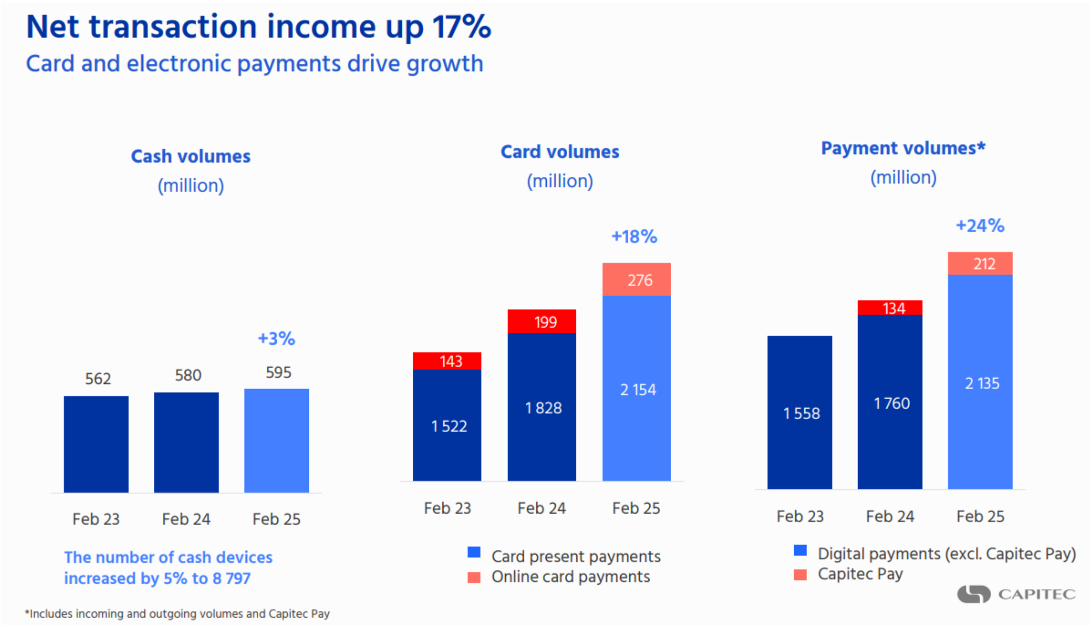
Capitec: a leader in innovation

There has been a lot of speculation about whether innovation in payments will disrupt traditional banking. The strongest evidence to refute this is the success Capitec has generated in building a super app for customers. Capitec stands out as a leader in South Africa when it comes to innovation and providing consumers with access to simple, convenient and cost-effective services. It has achieved this in both card and electronic payments whilst also looking to disrupt other markets like insurance and mobile communications.

From innovations in its payments offering such as Capitec Pay, to the disruption of the mobile data and airtime market with Capitec Connect (its MVNO offering), Capitec has been excellent at leveraging its very large customer base (24 million total clients) and many companies want to partner with Capitec as a result (e.g. Showmax). The premise behind the super app concept is to incentivise users to conduct all their activities within one ecosystem. This drives engagement and leads to better customer loyalty and retention levels. This ultimately creates value for all stakeholders. Users are incentivised through concepts such as cash back, rewards or discounts when transacting at partner shops. Leveraging such a large user base provides retailers direct access to a wider addressable market. Finally, Capitec is incentivised to keep every rand in its ecosystem, increasing the internal velocity of money and thus, revenue generating opportunities.

In its latest results, Capitec highlights the noticeable change in behaviour of clients moving from cash to digital transactions. It is evident that cash usage is slowing whilst card and electronic payment volumes are increasing at a much faster rate.

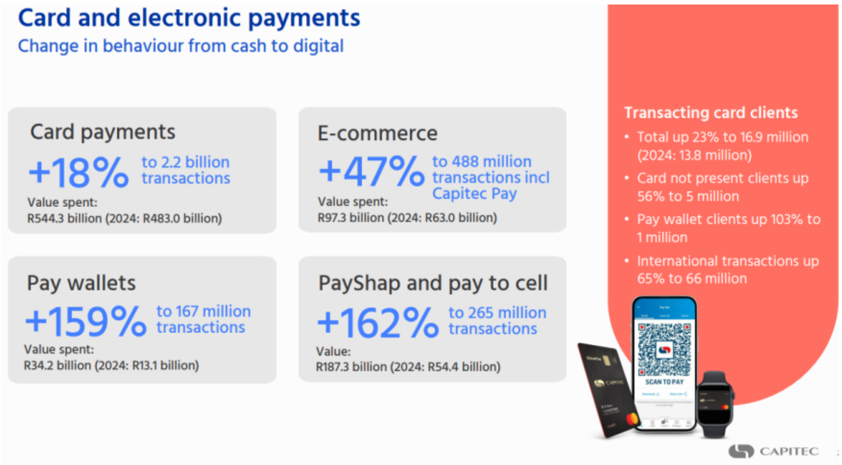
Figure 3: Card and digital payment volumes outpacing cash



Source: Capitec FY25 Investor Presentation

The slide below shows that within card and electronic payments the number of wallet transactions and PayShap and pay to cell transactions have risen 159% and 162% respectively. This highlights the success that Capitec is having in driving digital and card adoption. Notably, Capitec was also quick to move real time payments onto the more cost-effective PayShap rails and capitalise on a revenue generation opportunity in FY24 particularly, as other banks paid a much larger fee for transactions on older payment rails. Other banks have since moved payments onto these rails in response to this opportunistic move by Capitec.

Figure 4: Capitec's success in driving digital and card adoption



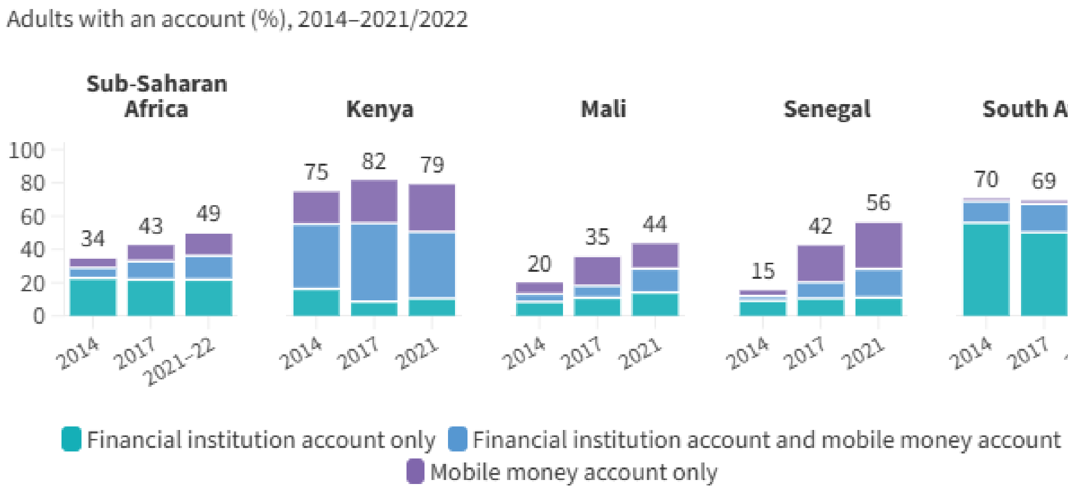
Source: [Capitec FY25 Investor Presentation]

Capitec has successfully reshaped the competitive landscape for the big four banks, by initially targeting a niche, underserved market before leveraging its success to build a quality franchise with an excellent track record. This has translated into further success in the payments ecosystem and it has become a formidable competitor alongside other banking players.

The SA banking sector is well developed, making the payments landscape exceptionally competitive.

Generally, it has proven more difficult than expected to roll out digital transformations in SA. This is due to the cost and the level of sophistication in the banking sector. Discovery Bank missed initial expectations and even Vodacom's foray into mobile money in South Africa has not been as straightforward as they would have liked. In contrast, the rise of M-Pesa in Kenya was very impressive, especially as a non-bank, but it benefitted from favourable market dynamics. Kenya's banking system was relatively underdeveloped in comparison to SA's, with millions of people excluded from the formal banking sector. The banking sector in SA has been well developed for many years and formal banking penetration has always been relatively high (see the figure below), making it very difficult for non-banks to successfully challenge or disrupt the incumbents.

Figure 5: Account ownership in Sub-Saharan Africa

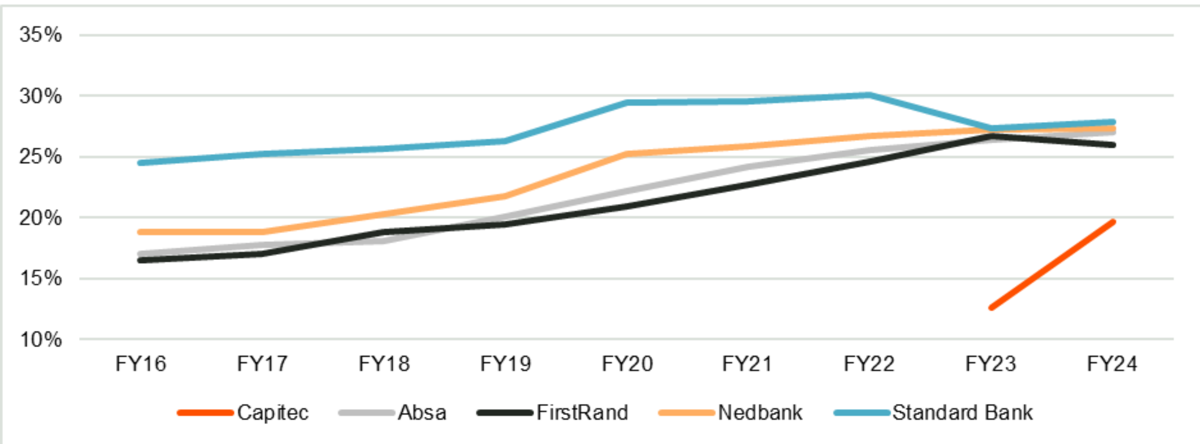


Source: [World Bank Group]

The banks are at the forefront of digital innovation.

The success that Capitec has enjoyed is a direct result of the bank investing heavily into their digital offerings. Cost profiles of the major banks have evolved considerably, with a much larger percentage of total costs now allocated to IT spend (as shown in Figure 6 below). This is a direct response to competition and changing customer needs with a preference for digital channels.

Figure 6: IT costs for SA banks (as a percentage of total costs)



Source: Denker Capital, UBS Research, Company reports

The big four traditional banks included in the analysis above spent an average of R17bn on IT related costs (including IT staff) in the most recent financial year. In contrast, Capitec spent R3.5bn on IT related costs. This highlights Capitec's advantage against the big four, given its IT systems have less legacy but also gives a sense of the spending power the banks possess and how they can respond to newer entrants. It is for this reason that we believe it will be very difficult for non-banks to disrupt the traditional banks and backward integrate into financial services.

The banks have all commented on how alert they are to imminent threats and have learnt from past mistakes. The recent announcement that Revolut, a popular UK headquartered digital bank, may enter the South African market has raised eyebrows given the global success it has garnered. It especially appeals to international travelers who desire multi-currency bank accounts at much lower fees. In what appears to be a very tactical response, Investec recently introduced multi-currency bank accounts to its private bank clients with favourable fee arrangements compared to the traditional 2-3% charged on cross-currency transactions.

A wave of innovation is reshaping payments, but the banks are responding.

Capitec and Vodacom are not the only companies in South Africa innovating in the financial services sector. Many other companies have invested in this exciting growth opportunity and aim to leverage the scale of their client bases. Discovery Bank has done well to carve out a niche offering despite initial challenges. Shoprite has developed their financial services business to capitalise on the large number of customers in their ecosystem (c.200 000 customers per day). Tyme Bank has demonstrated its ability to grow and challenge the incumbent banks and there are many fintech businesses that aim to solve problems or facilitate activity in the payments value chain.

Old Mutual's decision to build a bank is another sign of just how attractive it is for a company to own more of a customer's wallet. However, in our view it is difficult to see all these companies scaling their fintech channels profitably given the extent of banking penetration in SA, the level of innovation by the incumbent banks and the high degree of competition.

Vision 2025 has created an enabling platform for all players in the payments' ecosystem. However, the banks are not sitting back idly. This is highlighted by the extent of their IT spend and the success Capitec has generated.

Given this evidence, it is our view that it will be very difficult to disrupt the banks in a meaningful way**.** However, we do believe that there will be success stories in driving new revenue streams as we have seen with Vodacom. In light of this, we remain committed to identifying those companies that are at the forefront of innovation with the purpose of creating shareholder value.

Glacier Research would like to thank Craig Metherell for contributing to this week's *Funds on Friday.*

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Craig is an equity analyst with coverage in both developed and emerging markets. He started his investment career in 2013. Before joining Denker Capital, Craig spent three years at Avior Capital Markets where he researched and was responsible for the African banking sector (excluding South Africa). He also valued other frontier market financials for a wider South African, UK, European and US client base. Craig joined Denker Capital in 2019.