FINMARK TRUST

Making financial markets work for the poor

Retailers' motivation for offering financial services

prepared by Eighty20

CONTENTS

1 INTRODUCTION

A number of financial products and services are offered by or through retailers in South Africa. These span the broad financial services spectrum including transactional, savings, insurance and credit products. This research aims to understand retailers' motivation for providing these financial services more fully.

This study aims to build on several previous research projects. In 2009, the FinMark Trust commissioned a number of case studies on alternative microinsurance distribution in South Africa[1]. These studies highlighted the role that retailers play in the roll-out and development of insurance products targeted at lower income clients. Research commissioned by the FinMark Trust in 2011[2] highlighted the role that South African retailers have played in the provision of retail payment services, notably bill payment services and cash to cash transfers. Outside of South Africa, research commissioned by the International Labour Organization's Microinsurance Innovation Facility undertaken by the Centre for Financial Regulation and Inclusion (Cenfri) in Brazil and Colombia[3] highlighted how differences across the retail environment shaped the specific nature of financial services offered. In addition, stakeholder engagement by Cenfri with multi-national retailers, such as Wal-Mart, Carrefour and Elektra (which acquired banking licenses in Mexico and Brazil), emphasised the role of global strategy in shaping the delivery of financial services at a country level.

The FinMark Trust commissioned this study to map the landscape of financial services and products offered by retailers in South Africa, build an understanding of the business case for retailers to provide financial services and unpack the evolution of the product offering and its relative position within the wider area of value added services provided by these retailers.

The project identified four retailer types; namely, Fast Moving Consumer Goods (FMCG) retailers, cash-based clothing retailers, credit-based clothing retailers, and furniture and appliance retailers. Two dimensions frame this categorisation: an industry dimension and a tender or payment type dimension (namely cash versus credit). For the purposes of this analysis credit retailers are those where credit sales account for 40% or more of total merchandise sales.

[1] Smith A. & Smit H. 2010. *Case study: Hollard Insurance and PEP.*
Smith A. & Smit H. 2010. *Case study: Shoprite.* Available at:
http://www.cenfri.org/k2/item/46-update-on-microinsuranceinnovation-in-south-africa-2010

[2] Donian C. & Eltringham M. 2011. *The Profile of Retail Payment Services and Models in South Africa*. Available at: http://www.finmark.org.za/wp-content/uploads/pubs/Rep_Profile_ofRPSmodelsinSA.pdf

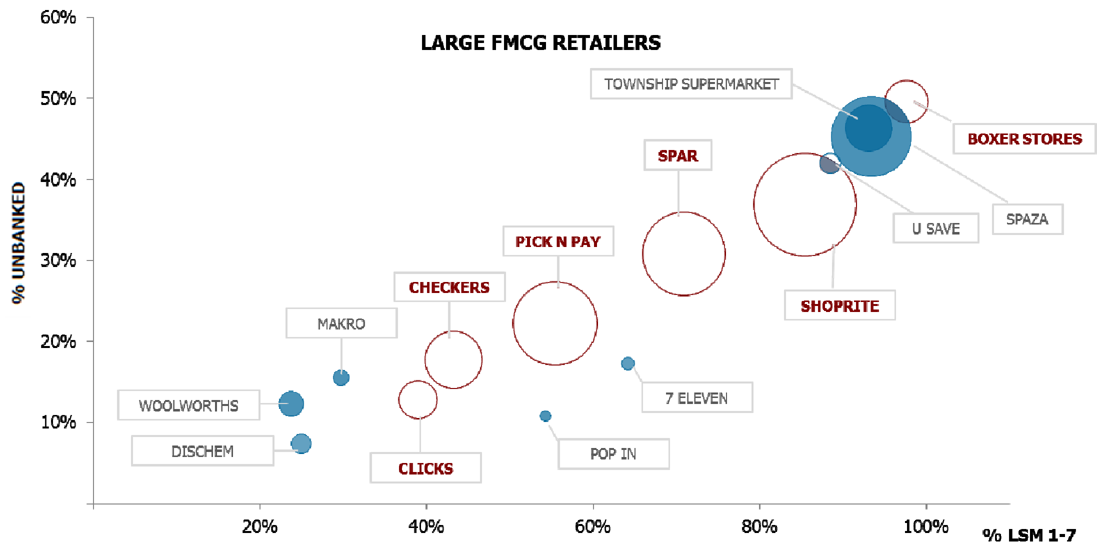
[3] Smit H & Smith A. 2011. *Mapfre Seguros: Retailer microinsurance distribution in Brazil.* Available at:
http://www.cenfri.org/k2/item/90-update-on-microinsurance-innovation-in-brazil-2011

2 CHARACTERISING RETAILERS

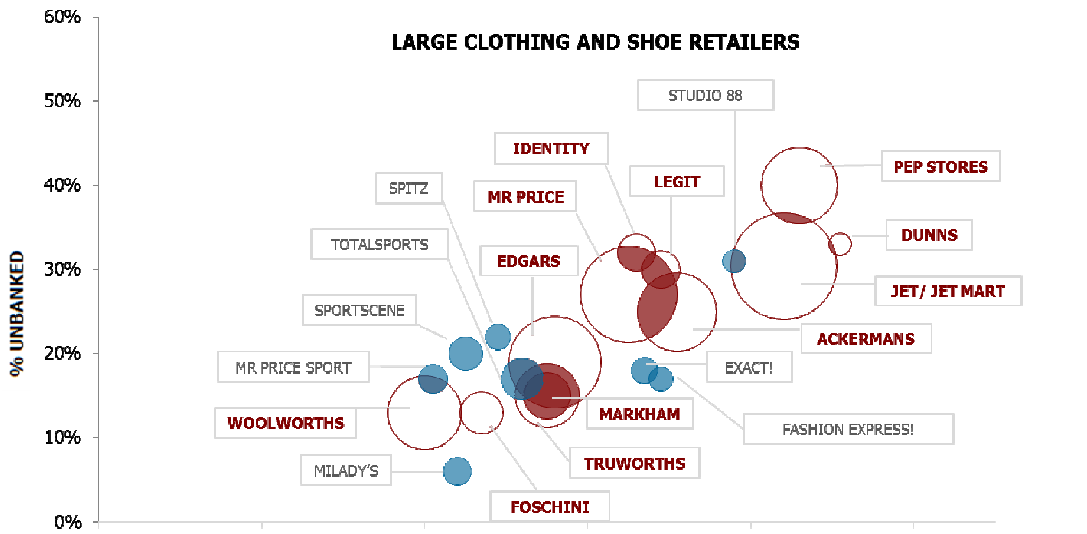
As a first step the research team identified the larger retail chains in South Africa and explored the profile of their customers using the 2012 All Media and Products Survey[4] ("AMPS"). In order to limit the analysis to retailers that operate in the low income space, the Living Standards Measure5 ("LSM") was used as a means of categorising the retailers' customers. Only the financial offerings of those retailers with a critical number of customers in LSM category one through seven were investigated in detail.

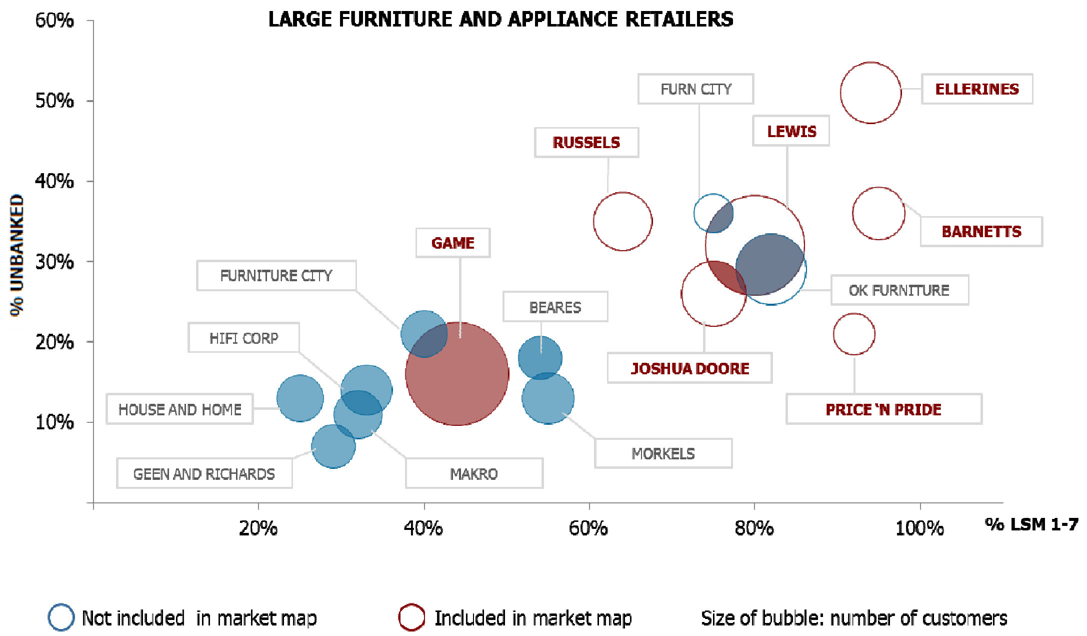
The bubble charts below show the large retailers in South Africa by the proportion of customers who are unbanked and in LSMs one to seven. The size of the bubble indicates the total number of customers. Bubbles in red indicate inclusion in the market mapping exercise. In total 25 retailers were included in the market map, which documents the range of products offered by each retailer, and the product features, servicing channels and pricing parameters for each product[6].

Chart 1: Customer characteristics of large retailers in South Africa[7]



[4] The All Media and Products Survey (AMPS) covers the total adult population of South Africa (aged 15+) based on 25,162 survey respondents. The survey covers demographics, psychographics, media, financial services and product usage at a brand level.
[5] The SAARF LSM (Living Standards Measure) divides the population into 10 LSM groups (10 being the highest to 1 the lowest), based on living standards using criteria such as degree of urbanisation and ownership of cars and major appliances.
[6] The market map can be accessed online at: http://xtract.eighty20.co.za/index_i.cgi?t=landing
[7] Data from AMPS 2012. FMCG retailer customers: 'From which stores do you usually do your food and grocery shopping?'. Large clothing and shoe retailer customers: Bought shoes or clothing from this store in the past 3 months. Furniture and appliance retailer customers: Bought furniture or appliances from this store in the past 12 months





The 25 retailers included in the market map offer a wide range of financial services as summarised in the table below. In some cases retailers offer niche products to specific segments of the market only. These are represented in blue in the chart below.

Table 1: Summary of financial products offered by retailers included in the market map

		FMCG						Clothing (Cash)			Clothing (Credit)									Furniture						
		Shoprite	Checkers	Pick 'n Pay	Boxer	Spar	Clicks	Pep	Ackermans	Mr Price	Edgars	Jet	Truworths	Identity	Foschini	Markham	Legit	Woolworths	Dunns	Joshua Doore	Barnetts	Price 'n Pride	Russells	Lewis	Ellerines	Game
Credit	Credit card			Niche			Core											Core								
	Store card or account		Niche						Core	Core	Core	Core	Core	Core	Core	Core	Core	Core	Core	Core	Core	Core	Core	Core	Core	Core
	Personal loan							Core										Core		Core	Core	Core	Core		Core	
Insurance	Balance protection/ credit life insurance						Core			Core	Core	Core	Core	Core	Core	Core		Core	Core	Core	Core	Core	Core	Core	Core	Core
	Funeral insurance	Core	Core				Core	Core	Core		Core	Core			Core	Core			Core	Core	Core	Core	Core		Core	
	Life insurance						Core				Core				Core	Core										
	Asset insurance[8]						Core				Core	Core	Core		Core	Core		Core		Core	Core	Core	Core	Core		
	Critical illness[9]						Core			Core					Core	Core										
	Other insurance[10]	Core					Core			Core	Core	Core			Core	Core		Core								
Savings	Lay-bye[11]							Core							Core	Core				Core	Core	Core	Core	Core		
	Savings stamps[12]	Core	Core		Core																					
	Bonds			Core																						
Transac-tional	Bank account			Core																						
	Money transfer	Core	Core	Core	Core	Core		Core																		
	Cash back	Core	Core	Core	Core	Core		Core																		
	Third party bill payments	Core	Core	Core	Core	Core		Core																		

■ *CORE PRODUCT* ■ *NICHE PRODUCT AVAILABLE ON REQUEST OR TO SPECIFIC SEGMENTS OF THE MARKET*

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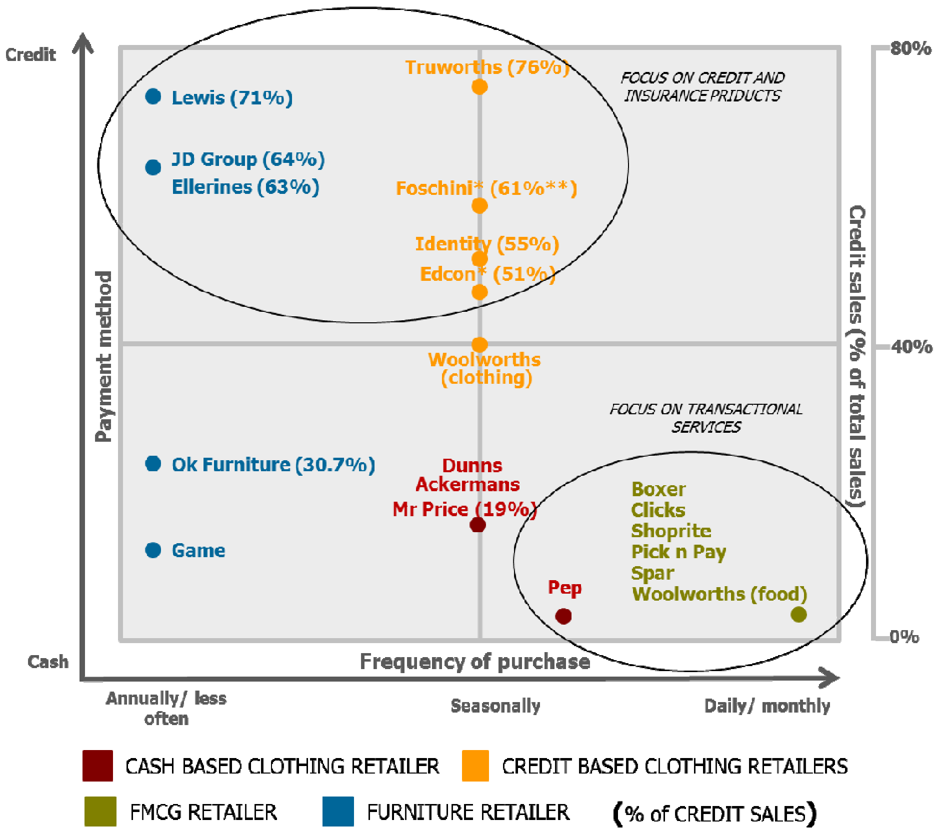
8 Asset insurance includes car, household contents, homeowners, cell phone and asset insurance
9 Critical illness includes cover for cancer
10 Other insurance includes dental, legal, lost card, travel and accident insurance and hospital cash plans
11 A lay-bye agreement is a way of paying for goods over an agreed period of time, with the retailer holding the goods until the customer has paid the full price. To lay-bye goods, the customer pays a small deposit, and subsequently makes regular repayments until the total price is paid.
12 Savings stamps can be purchased by customers in R10 ($1) denominations. The stamps are collected in a savings book which the customer can redeem for the cash value of the stamps at any time

A high level review of the market map highlights the clear distinction between the financial services portfolios of credit-based as opposed to cash-based retailers. Credit-based retailers typically offer products that are underpinned by their retail credit products. These retailers have further diversified into insurance and additional non-retail credit products by leveraging their strong customer relationships, rich internal customer databases and monthly instalment collections platforms. In contrast cash-based retailers, including FMCG retailers such as Pick n Pay and Shoprite, tend to offer simple, convenience based, high frequency transactional services such as cash withdrawals at point of sale (POS) and money transfer services. These services leverage the payments switches developed to process payments between banks and customers. In many cases the activities and processes required at point of sale to fulfil the transaction align closely with retail servicing activities (such as scanning barcodes).

Closely associated with the profile of the retailer in terms of merchandise offering and tender type is the purchase frequency that characterises shopper behaviour. Furniture shopping is less frequent than clothing shopping which in turn is less frequent than grocery shopping. Retailers that are characterised by high shopping frequency offer high frequency transaction services, while retailers with seasonal or annual purchasing frequency focus on products that require less frequent interactions with clients, such as credit and insurance products.

These patterns are illustrated on the schema below. It categorises retailers in terms of their dominant payment mechanism (cash versus credit) and the purchase frequency associated with their merchandise. The clustering of retailers around key products is clear. An exception to this is Pep, a cash-based clothing retailer that offers high frequency transaction services that are more typically offered by FMCG retailers.

Chart 2. Market map retailers by payment method and frequency of purchase



3 AN OVERVIEW OF CASE STUDY RETAILERS

Five retailers were selected from the market map as case studies for more detailed analysis; namely, the JD Group (a furniture and appliance retailer), Edcon (a credit-based clothing retailer), Pep (a cash-based clothing retailer), Shoprite Checkers (an FMCG retailer) and Pick n Pay (an FMCG retailer). These five case studies were used to develop the themes reviewed in this synthesis document. A brief overview of each retailer is provided below, with more detailed case studies published separately as stand-alone documents.

3.1 JD Group

The JD Group is a diversified furniture retailer. The Group's furniture retail division consists of seven South African furniture retail brands: Barnetts, Bradlows, Electric Express, Joshua Doore, Morkels, Price n' Pride and Russells. In total, these brands have approximately 1 000 furniture retail stores across the country. Aside from retail stores the JD Group owns a building supplies retailer and most recently has introduced two long term vehicle rental products.

The financial services division of the JD Group was separated from the retail business in 2009 to enable the division to focus on identifying opportunities in the financial services space independent of the Group's retail operations. Over the past five years the group has made a noticeable shift from its original positioning as a furniture retailer that offers financial services, to a diversified retailer with the majority of its operating profits derived from its independently run financial services division.

The Financial Services division operates as a distinct business that leverages the assets of the retail divisions but operates independently, and while there is an in-store presence, this is staffed and managed separately. There is a separate representation of the retail and financial services divisions at board level, and financial services are reported on separately in the annual report.

JD Financial Services is the Group's most profitable division. It contributed 53% of Group operating profit compared to 21% generated by Furniture Retail for the 2012 financial year. Annualised before tax Return on Equity (RoE) for the financial services division was 26% (Group: 13.3%). JD Financial Services underwrites all its financial offerings in-house and has two wholly owned insurance entities.

While the current credit book is still dominated by furniture credit, the personal loan book has grown strongly. Other more recently launched products within the financial services division including building material finance (CrediBuild) and long term vehicle rentals (Ariva and Unirent) are not associated with furniture sales. The Division aims to enable its upwardly mobile consumer base to fund an aspirational lifestyle. It actively seeks products that enable it to diversify its offering away from retail credit and to extend the average term of facilities it offers clients.

3.2 Edcon

Edcon is the largest non-food retail group in South Africa with a market share of the South African clothing and footwear market that is nearly twice that of its nearest competitor. Edcon consists of a number of retailers, although for purposes of the case study the two largest clothing stores were considered: Edgars (175 stores) and Jet (318 stores across South Africa, Botswana, Lesotho and Swaziland). Edcon has offered credit to customers since its inception in 1926 and is currently the largest provider of credit in Southern Africa by number of customers with 3.8 million credit accounts.

Like the JD Group, Edcon has also separated its financial services offering from its retail activities. The division is represented directly at board level and the company reports on financial services separately in the Group's annual report. One quarter of Edcon's profits are generated from financial services.

Edcon does not underwrite its products; Hollard underwrites its insurance products and Absa Bank underwrites its credit book. While the financial services division is significant, the group is first and foremost a retailer, offering financial services to support retail activities. Its insurance products are viewed as 'just another product' offered to retail clients.

3.3 Pep

Pep has grown into the largest single brand clothing retailer in South Africa with a network of approximately 1200 stores in South Africa and an additional 123 stores across Namibia and Botswana. Pep's stores are often located in rural areas where access to financial services is limited. According to AMPS (2012), 86% of Pep's customers are in LSM's one to seven and 40% are unbanked.

Pep has a separate financial services department that oversees the development and roll out of financial services and products. All decisions are made centrally and executed locally, and products and services are uniform across stores. Pep stores do not have a separate counter for financial services; all services are offered through each till point.

Pep currently offers customers a range of transactional products including store to store money transfers, cash withdrawals at till point, funeral insurance and lay-byes as well as personal loans underwritten by its subsidiary Capfin. Pep has launched a number of innovative offerings that target the lower income market. It was one of the first retailers to sell funeral policies off the shelf in the form of a starter pack in 2006[13]. In another first, Pep partnered with Mukuru to facilitate international money transfers from South Africa to Zimbabwe in 2012[14].

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[13] There are currently four funeral insurance products sold in stores with premiums ranging from R19.99 ($2.00) per month to R69.99 ($7.00) per month.

[14] Although users must first register at an Inter Africa branch subsequent transfers can be done through a Pep store at a cost of 10% of the amount of money sent.

3.4 Shoprite

The Shoprite Group is Africa's largest food retailer, with 1 334 corporate and 406 franchise outlets in 17 countries across Africa and the Indian Ocean Islands. The Shoprite Group consists of a number of stores including FMCG stores, furniture and appliance stores, pharmacies and liquor stores. The case study focuses on its two largest divisions; Shoprite (339 grocery stores in South Africa) and Checkers (162 Checkers grocery stores and 28 Checkers Hyper grocery stores in South Africa).

Shoprite separates its financial services offering from its core retail offering in store by having a separate counter for financial services, called the Money Market. The Money Market was introduced in 1998 to strengthen Shoprite's positioning as a one-stop shopping destination. Shoprite estimated in 2008 that more than 50% of its clients make use of the counter while in the store.

Shoprite's current financial services offering includes an extensively used store to store money transfer service which is estimated to hold between 70% and 80% of the money transfer market in South Africa[15], savings stamps and a range of insurance products. It also offers third party bill payments, cash withdrawals at till point as well as SASSA Grant payments.

3.5 Pick n Pay

The Pick n Pay Group is one of Africa's largest retailers of food, general merchandise and clothing. Pick n Pay currently has approximately 194 corporate stores and 291 franchise stores in South Africa. It was the first retailer to enable point of sale cash back, the first to offer third party bill payments and launched a low cost bank account called Go Banking in 1997. Nedbank, its banking partner, had an in-store presence in over 160 stores throughout the country.

Unlike the Money Market counter in Shoprite and Checkers stores, Pick n Pay does not have a separate counter for financial services. Instead Pick n Pay offers the majority of financial services at till points.

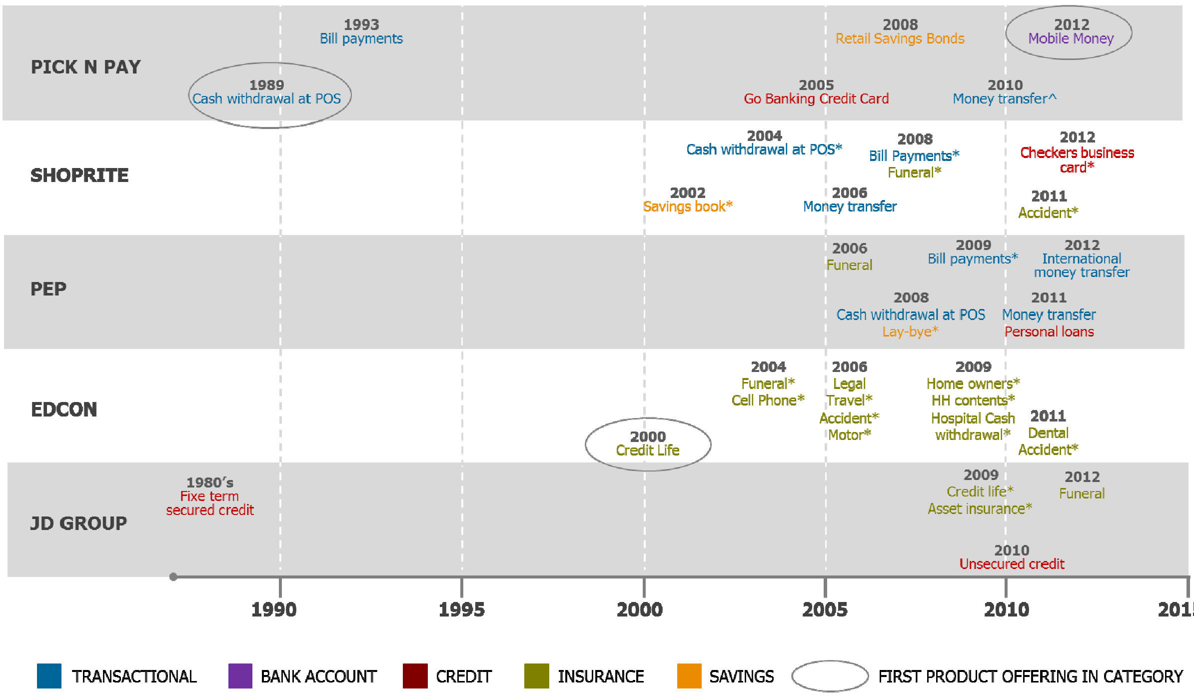
Pick n Pay currently offers transactional services including third party bill payments, cash withdrawals at till point, SASSA Grant payments and a mobile bank account called Mobile Money launched with MTN and TYME in 2012. In addition, the retailer offers Treasury-backed retail savings bonds and a credit card through GO Banking.

[15] Estimate provided in an interview with Andrew Lovegrove, Technical advisor on retail payment systems, remittances and regional payment systems integration

3.6 *Roll out of financial services*

The chart below summarises the dates at which various offerings were introduced by each of the case study retailers. Products have been colour coded in line with the nature of the offering. As illustrated, credit retailers have offered credit for generations. However, the provision of other non-retail credit, transactional and insurance products by retailers is a more recent phenomenon. This is in part a response to changes in regulation, and innovation and adoption of new technologies, most notably cell phones.

Chart 3. Timeline of products



Note^: Pick n Pay Money Transfer was discontinued in April 2013 and re-launched as part of the Mobile Money product
Note*: Estimated date of product launch
Note: Edcon has always offered credit to their customers, this is part of their business model and so is not show in the chart above

In the late 1980's and early 1990's Pick n Pay was at the forefront of offering convenience based transactional services. Pick n Pay developed a retail switch that allowed for cash withdrawals at the Point of Sale (POS) and also developed a system for accepting bill payments at POS. Both cash withdrawals at till point and third party bill payments are now offered by several large FMCG retail chain stores as well as by Pep.

Credit retailers began to offer insurance in 2000, focusing initially on insurance directly linked to retail credit products, such as credit life and balance protection. Edcon was the first retailer to offer credit life insurance in South Africa. More recently furniture and appliance retailers have begun to offer asset insurance. Aside from insurance, credit retailers have also diversified away from retail credit and begun to offer unsecured and other credit products.

Some retailers offer savings products, principally lay-byes, although these tend to be far less of a focus. More innovative savings products include Shoprite's savings books and Treasury's Retail savings bonds sold through Pick n Pay.

4 PRIMARY MOTIVATION FOR OFFERING FINANCIAL SERVICES

The primary motive for retailers to offer financial services is to increase revenue and bottom line profits, either directly from the provision of financial services or from increased sales of existing product offerings enabled by the provision of financial services. The drivers for increased profits can be grouped into three broad categories[16]:

- Increased footfall
- Driving more profitable customer behaviour
- Leveraging existing assets

Each of these is discussed below in more detail.

4.1 Increased footfall

Retailers can increase footfall by acquiring new customers and by increasing the number of interactions with existing customers. To do this, retailers can offer financial services that are in demand within their target markets in order to draw more customers into the retail environment more frequently. For example, by offering money transfer services, retailers such as Shoprite attract both sending and receiving parties into their stores, providing an opportunity for both to purchase. Likewise by enabling customers to pay monthly bills in-store retailers provide an additional incentive for prospective customers to visit stores on a regular basis.

Shoprite Checkers specifically highlighted this as the primary rationale for creating its Money Market. To quote from its 2007 Annual Report; "Money Market forms part of the Group's non-core value-added strategy aimed at increasing consumer traffic in its stores. The main focus of the services offered is adding value to consumers' shopping experience by providing convenience and saving the consumer time, so turning outlets into destination stores[17]". Likewise Pick n Pay highlighted customer convenience as the primary driver behind its decision to offer financial services. By offering a frequently utilised financial service in an already accessible environment the retailer adds value to the shopper by enabling him or her to avoid time and effort required to conduct the transaction elsewhere. This enhances the destination value of the retail outlet and attracts customers who value the convenience of being able to access a range of services at one point.

[16] A fourth factor, namely lowering operational costs was also considered. This is most obvious in the case of cash back services which reduce cash holdings thereby minimising risk and cash handling fees for the retailer. However in conversation with retailers this benefit, while acknowledged, was regarded as an add-on and not the primary reason for offering the service.
[17] Source: Shoprite Holdings Limited 2007. *Annual Report*. Available at: *http://www.shopriteholdings.co.za/InvestorCentre/Pages/Investor-Kit.aspx*

Box 1: Convenience and in-store servicing models

In-store processes and servicing models for convenience-based services can differ; Pick n Pay and Pep service customers at till point while Shoprite Checkers has a separate Money Market counter. There is clearly a trade-off between delivering high convenience to the financial services client by offering services at till point, and negatively impacting on the shopping experience of the 'next in line' customer.

In some cases the decision to offer services in a separate environment is driven by regulatory requirements. For instance, with regard to money transfer services the sender is required to present identification prior to use. Front line staff must capture ID numbers of the sender, and then process the financial transaction. Retailers would ordinarily prefer to conduct this transaction away from tills as it is time-consuming. Both Pep and Pick n Pay have redesigned their money transfer services to circumvent this challenge. Pep has linked the offering directly to membership of its shopper loyalty programme, the Pep Club. Pep can therefore leverage off a single registration event that takes place when customers sign up for the Pep Club. In order to send money customers simply swipe their loyalty card which contains their details. Pick n Pay on the other hand has embedded its new money transfer service within its Mobile Money banking solution. Transfers are offered as a real-time mobile payment from one Mobile Money account holder to another and no registration is necessary.

A number of credit-based clothing and furniture retailers encourage customers to pay their accounts in store. This allows the retailer to engage with the customer and encourage them to spend when the facility exists on their accounts. Likewise with regard to funeral insurance offered by Pep, customers pay monthly premiums in cash in the store, bringing them into the retail environment on a regular basis.

With the growth in online and mobile channels, and the integration of multiple channels such as ATMs and e-wallets, retailers have begun to re-think the convenience proposition as it pertains to various segments of the market and have redesigned services to take these changes into account. Pep's new money transfer service is initiated in store in cash while its collection model leverages Absa's ATM network (receivers can only withdraw funds at an ATM). On the other hand Pick n Pay's solution can be initiated in store or out of the retail environment using a cell phone while recipients can only access cash in-store.

Box 2: When being a destination backfires: SASSA payments at FMCG retailers and money transfers at Pep

The larger FMCG retailers facilitate the payment of SASSA Grants including Old Age Pensions, Child Support Grants and Disability Grants through their stores. Approximately 16 million grants are paid each month. Recipients access funds through a Mastercard debit card. Retailers report overwhelming demand for the service, with very high volumes of customers coming into stores on SASSA payment days, so much so that in some cases retailers hire marshals to control crowds. Retailers are not paid to distribute funds, and in fact incur direct costs to offer the service. For instance, some stores need to order in cash and hire additional cashiers and security guards to facilitate payments. Further, retailers pay the 1.8% interchange fee on the transaction. The high volume of cash moving through tills creates significant risk and high numbers of customers moving through stores often inadvertently cause damage. Congestion in-store also makes it effectively impossible for the retailer to service their regular customers.

Retailers indicate that most grant recipients withdraw the full amount of the grant in one withdrawal, and relatively few purchase items in store. Where retailers require a purchase, customers often select a low value, low margin products.

All in all it would appear that attracting customers into the store comes at very high cost to the retailer, arguably in excess of the benefit. Deliberate strategies are required to turn this around. For instance, Pick n Pay offers specific incentives to encourage SASSA grant recipients to spend in store. The retailer distributes a booklet of vouchers with discounts on selected items. In addition, in some stores those who wish to withdraw only are directed to specific tills where queues are longer. Those who purchase groceries can use tills with shorter queues.

Pep's initial experience with money transfers also highlights the potential pitfalls of attracting customers into stores. The service proved to be exceptionally popular, so much so that many customers visited stores just to use these services without making any other purchases. This had a negative impact on the retail environment with long delays at till point and stores running out of cash. After extensive basket and store level analysis both services were re-designed to curb the massive demand. Pep introduced purchase thresholds in the case of cash back services. The retailer also increased the price of money transfers and more recently has stipulated that only Pep Club members would have access to this service.

4.2 *Driving more profitable customer behaviour*

Financial services can be used to drive more profitable behaviour from customers once they are in store either by encouraging customers to increase basket size or by incorporating higher margin products into the basket. This is clearly the case with the provision of credit in general; customers can pay back over time enabling purchases by those who might not have the required lump sum. Cash-based retailers also use financial services to drive more profitable customer shopping behaviour. In some cases they do this by restricting access to well-priced financial services to customers who meet certain criteria, for example to those who spend above a set threshold or to those who belong to a club or loyalty programme.

Pep has done this most visibly; only shoppers who spend a minimum of R50 ($5.00) in store can withdraw cash at the point of sale, and only Pep Club members can send money through Pep's money transfer service. Membership of the Pep Club is in turn limited to those customers who have a sim card purchased at a Pep store. In line with agreements between Pep and Mobile Network Operators, Pep earns commission on all airtime purchases associated with sim cards purchased at Pep. The club offers a range of benefits to members. However for the member to qualify for the Club's free funeral cover the sim card must specifically be a PEPcell branded sim card. Pep Club's free funeral cover is linked to the customer's purchase of airtime and the length of time that the sim card has been active. This is summarised in the table below.

Table 2: Pep Club free funeral cover details

	Average airtime usage				
Months sim activated	**R0-R50 ($0 - $5)**	**R50-R75 ($5 - $7.50)**	**R75-R150 ($7.50 - $15)**	**R150-R500 ($15 - $50)**	**R500+ ($50+)**
0-6	Accident cover of R500 ($50) only	Accident cover of R500 ($50) only	Accident cover of R500 ($50) only	Accident cover of R500 ($50) only	Accident cover of R500 ($50) only
7-12	R0	R750 ($75)	R1 000 ($100)	R1 250 ($125)	R1 500 ($150)
13-24	R0	R1 500 ($150)	R2 000 ($200)	R2 500 ($250)	R3 000 ($300)
25-36	R0	R2 500 ($250)	R3 000 ($300)	R3 500 ($350)	R4 000 ($400)
37+	R0	R3 500 ($350)	R4 500 ($450)	R5 500 ($550)	R6 500 ($650)

This structure provides a clear incentive to customers to purchase PEPcell sim cards and to continue using them.

More generally loyalty programmes can be an effective tool to incentivise more profitable customer behaviour and to gather customer-linked basket data for cash retailers. Like Pep, other retailers use financial services as part of a package of benefits that incentivise customers to join and remain on as members of the programme. Clicks, a pharmacy, health, home and beauty retailer with a successful customer loyalty programme offers free funeral cover to its members[18] as a value added benefit. Like Pep's funeral insurance, the benefit pay-out for this policy is directly linked to the value of purchases over the six months leading up to the date of claim. Likewise, the Edgars club offers members free funeral cover as part of a bundle of value added services[19].

4.3 Leveraging existing assets

Retailers have invested in physical store networks and payments infrastructure in order to operate their core retail businesses. In addition, retailers have strong and trusted brands and some retailers have existing lines of communication to their customers through club newsletters and magazines. Credit retailers in particular have rich client data that can be mined to inform merchandising decisions, financial product design and to generate sales leads. All these assets can be leveraged to provide financial services that offer good value to customers and generate high profits for the retailer.

By way of example, in the FMCG retailing industry Pick n Pay first offered cash withdrawals at till point leveraging the switch it had developed in the 1980s to process credit card payments seamlessly at point of sale. The switch also enabled Pick n Pay to offer third party bill payments to customers. Shoprite Checkers has leveraged its wide physical footprint to offer money transfers through its Money Market. While that retailer does not report on the profitability of the Money Market separately in its financial statements, it is entirely possible that financial services enhance the viability of stores in poorer areas that might otherwise not break even.

With regard to credit retailers, the retailer must gather and maintain customer data in order to provide credit. Retailers also need to develop loan origination and collections platforms. Together these facilitate on-selling of additional credit products. In the case of the JD Group, the focus of its financial services division has been on diversifying its credit offerings away from financing furniture sales which have a natural term limit aligned with the lifespan of the underlying security. It introduced personal loans in 2010 which are offered primarily to existing clients (in 2012 roughly 60% of personal loans clients were originally furniture credit clients). Its strategy is increasingly independent of furniture retailing and focuses on financing the lifestyle aspirations of its upwardly mobile client base[20].

In addition to expanding the portfolio of credit products away from retail credit, credit retailers in both the clothing and furniture industries offer add-on insurance products to enhance margins. Insurance offerings

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[18] Becoming a member of the Clicks Club is free

[19] Edgars and Jet Club members pay a monthly fee of between R29 ($2.90) and R49.50 ($4.95) depending on the benefits package they select. Free funeral benefits range from R3,000 ($300) cover for main member and R1,500 ($150) cover for partner to R7,000 ($700) cover for main member and R3,000 ($300) cover for partner

[20] In line with this it has introduced a 48 month car rental product in conjunction with Imperial, as well as building material loans offered through the building materials subsidiaries of the JD Group.

such as credit life insurance and in the case of JD Group, asset insurance, initially complement retail and store credit offerings.

Box 3: Brand values and business cases

As noted the financial services divisions of many credit retailers are exceptionally profitable. By way of example Edcon generated 35% of its profit from its financial services division while the JD Group generated 53% of its profit from JDGroup Financial Services. On the face of it, there would seem to be an overwhelming case for retailers to offer financial services, particularly credit.

Nevertheless in some cases retailers have actively decided not to offer credit as it conflicts with core brand values. Those that do offer credit and related insurance products often have to deal with negative publicity and damage to the brand emanating from origination and collections practises. Credit retailers in South Africa are often accused by journalists of taking advantage of customers and are frequently the target of investigation by regulators. For example, a Moneyweb article from October 2012[21] reported that customers at furniture retailers "would find themselves paying more for the insurance than they do in interest". The article also noted that "none of the lenders approached by Moneyweb had explained insurance charges before drafting the various quotes. They also did not tell the customer that third party options are available".

Aside from these investigations, the very low claims ratios associated with credit life and asset insurance[22] typically sold together with credit by retailers indicates that customers may be unaware that they have these products.

It is precisely because these products are so profitable that front line staff are often incentivised to sell, and do so at times with little regard for the needs of the customer. Where clients are relatively poor this behaviour increases the reputational risk to the retailer.

Added to this, retailers can leverage client data and collections platforms to offer additional insurance products that are not linked to store credit. Edgars and Jet has done this particularly well. It now has an insurance portfolio of ten products including funeral insurance, motor and household insurance, legal expense insurance and even dental accident insurance. Its insurance products are offered to account holders only and entry level premiums are relatively low. For example, the monthly premium for its Personal Funeral Plan is R19.50 ($1.95). Products are actively marketed in-store to clients who come in to pay accounts, through the

[21] "Furniture retailers nail credit clients with insurance fees" 29 October 2012 by Malcolm Rees. See http://www.moneyweb.co.za/moneyweb-financial/retail-customers-pay-more-for-the-insurance-than-i

[22] For instance, Monarch, the insurer that underwrites credit life policies for Lewis Stores had a claims ratio (claims incurred as a percentage of earned premium) of 20.5% in 2012. JDG Micro which underwrites the asset insurance sold by the JD Group had a claims ratio of 1.9% in 2012. The average claims ratio for short term insurance as a whole in 2012 was 63%

Edgars and Jet Club magazines which have very wide readership (the Edgars Club magazine has a readership of 1.6 million and the Jet Club magazine has a readership of 4.3 million[23]) and through its outbound call centres which generate leads off the existing client base. According to Edcon's 2012 annual financial statements, the retailer's insurance division has 5.6 million active policies which generated R541 million ($54 million) in profits.

[23] Source: AMPS 2012. According to AMPS, a reader is defined as anybody that has read or paged through any copy of a publication during the past 6 months – regardless of whether it is their copy or not. It includes any separate parts, sections or supplements that are included with the publication