The Cost-Benefit of Regulation in South African Banking

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Abstract

In order to continue the economic transformation of South Africa, conditions must be created to encourage private sector activity and enterprise development that will translate into economic growth. The banking industry has a major role to play in the creation of this enabling economic environment and the government is using banking regulation to align the effort of the banks towards this goal. This effort will only be effective if the benefits and costs of the regulations can be identified, the benefits exceed the costs and they accrue to the correct stakeholders.

The study reviews five recently promulgated legislative elements using triangulated documentary and primary research. The research reveals a conflict between the objectives of international compliance and social and economic development. The support of the enabling environment by the regulations is skewed towards the international compliance objective at the expense of the social and economic objectives. The benefits in the legislation accrue to banking customers and South African society and the major costs are incurred by the banks. If the banks use a positive, long term approach and view regulation as a business opportunity rather than a compliance initiative, the benefits of the regulation will exceed the costs and the regulation will contribute to the overall enabling economic environment. A model has been developed to show the relationship between the enabling environment, the regulation, the costs and benefits accruing to the stakeholder groups and the effects of the approach of the banks on the achievement of the objectives.

Declaration

I declare that this research project is my own, unaided work. It is submitted in partial fulfilment of the requirements of the degree of Master of Business Administration for the Gordon Institute of Business Science, University of Pretoria. It has not been submitted before for any degree or examination in any other university.

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1.1 Description of the problem and background

1.1.1 Introduction

Since the arrival of the new millennium, the regulatory environment governing banking in South Africa has changed substantially. The implementation of international standards such as the Basel Accord and consumer protection and anti-money laundering legislation in the form of the Financial Advisory and Intermediary Services Act 2002 (FAIS) and the Financial Intelligence Centre Act (FICA) have dominated the compliance activities of banks in South Africa. The self imposed Financial Services Charter (FSC) has introduced a number of measures which the South African banking community have committed to achieve. These new regulations have created a complex regulatory environment that requires substantial management effort and company resources to ensure compliance (Dreyer and Weinstock, 2006). The complexity and cost required to comply with these regulations raises questions as to why they are being introduced and what benefit they will achieve.

Such regulation is not formulated without very specific goals to achieve defined benefits for certain groups of stakeholders. These regulations are part of a government plan to create an enabling environment that will stimulate the expansion of the private sector and foster greater economic growth. However, in a complex environment such as banking, the intended impact of such actions may not necessarily be achieved in the implementation. To draw conclusions on the effectiveness of achieving the intended goal in this complex environment, it is important to understand the rationale behind the regulation, the benefits that were set out to be achieved and the costs associated with the regulatory implementation process. A cost-benefit analysis must then be performed to understand whether the benefits exceed the costs. Also during this analysis, it is important to determine which groups of stakeholders are affected and how they are affected. In this regulatory environment, the benefits may accrue to different stakeholders from those that incur the cost and this may affect the impact of the regulations.

1.1.2 Government intention

The government intention behind the increased regulation is clear when the post 1994 economic policy is reviewed in context of the contribution of the banking industry. In 1994 the ANC inherited a country that was politically, socially and economically unstable (Towards a ten year review, 2003). The legacy of the Apartheid system was a political structure geared to perpetuate a strict racial hierarchy disenfranchising the majority, a social environment in which the majority of the population were under-educated, unemployed and poverty stricken and an economy, isolated by sanctions, experiencing declining growth, ballooning public sector debt and companies that, due to import substitution industrialization, had no ability to complete in global markets. The government realised that in order to support the required political and social change, sustainable economic growth was crucial.

Calamitsis (1999) and Bannock, Gamser and Juhlin (2003) agree that sustainable economic growth requires a basis of sound macroeconomic policies coupled with the development of a strong private sector as the principle engine of growth. To create this economic engine room, the ANC introduced the Reconstruction and Development Program in 1994 followed by more comprehensive economic policy in 1996 called the Growth, Employment and Redistribution Strategy (GEAR). GEAR was built on the two pillars of macroeconomic stabilization and the creation of an enabling economic environment. An enabling economic environment uses the principles of open markets and privatization to create a set of conditions that encourage the growth of private sector activity and facilitate enterprise development (Kirkpatrick and Piesse, 2001).

Whilst these two pillars formed the basis of the GEAR policy, as the country progressed through the 1990s and into the new millennium, the main focus of the GEAR policy became the stabilization of the macro economy. The government policy largely focused on and achieved the creation of a sound macroeconomic basis required as a foundation for growth (Grandes and Pinaud, 2004; Moolman, 2005). It addressed and successfully improved the overall economic environment, ensured stable, low inflation, low interest rates, a stable improving currency and stimulated high economic growth.

Currently, however, despite the favourable macroeconomic environment, the second part of the strategy, the enabling environment, has not yet yielded the success required. Economic growth is not yet enough to ensure poverty alleviation, reduce unemployment and achieve a more equitable income distribution (OECD, 2004). The government has turned its attention to ensuring that the enabling environment is strengthened to become effective in fostering the private sector as a major growth engine.

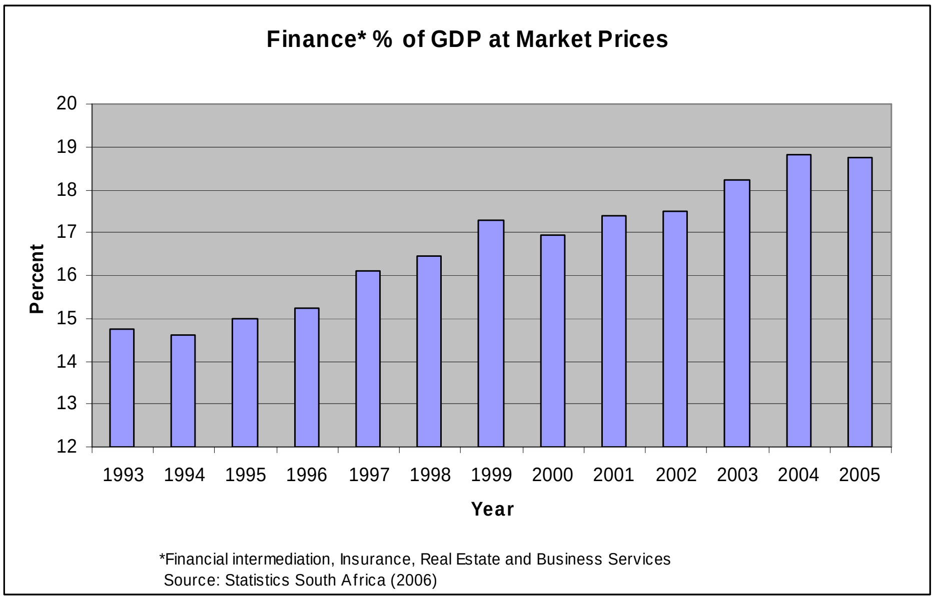
1.1.3 The South African banking industry

The government is looking to the banking industry to increase its role as a major facilitator of growth. Banks are central within a financial system (SARB, 2005) and create the infrastructure through which the economy operates. The banking system facilitates the monetary policy, provides intermediation between the borrowers and lenders in the economy and ensures the productive use of savings (Guynn, 1997; Hawkins, 2003a; Levine, 1997). Through this intermediation function and the attraction of savings, the banks can create the capacity to finance individuals and businesses to achieve their financial goals and bring more of the economically inactive people into the mainstream of the economy.

The banking system in South Africa is well developed and compares favourably with the banking systems in industrialised nations. It is effectively regulated, comprising a central bank, a few large, financially strong banks and investment institutions, and a number of smaller banks including many foreign banks that have set up operations in South Africa. The Banks Act, governing banking in South Africa, is primarily based on similar legislation in the United Kingdom, Australia and Canada.

The banking industry is part of the financial services sector in South Africa which is a large contributor to the country's Gross Domestic Product. As can be seen in figure 1 the contribution of this sector has increased substantially over the past 12 years and appears to be stabilizing at a level of just less than 19%.

Figure 1: Financial sector % contribution to GDP



According to the South Africa Reserve Bank, (SARB, 2005) there are 17 registered banks and 15 registered local branches of foreign banks. The total assets of these institutions are R1 655 billion (SARB, 2005) which grew at a rate of 12% in 2005. Focusing on the registered banks, four large banking institutions dominate the banking industry, Standard Bank, ABSA, First National Bank and Nedbank. In 2005 (PriceWaterhouseCoopers, 2005), these four institutions together had 19.8m customers, held 31.2m retail accounts, had 2 500 branches and employed 166 118 people. The other domestic banks employed almost 8 000 people and the foreign banks employed 2 200 people bringing the total employment by the sector to 176 000 people.

This sector represents a large force in the South African economy. However, if the number of loans to the lower end of the population in the big four banks, represented by micro loans (615 000 in 2005) and the new, industry wide, low income account, Mzanzi, (927 000 in 2005) (PWC, 2005), are compared to the total retail accounts they represent only 5% of the accounts. If the focus of this economic force can be placed on the provision of lower income financial services, more of the economically inactive people can be moved into the mainstream of the economy.

It is to this end that the government is seeking to stimulate increased competition between banks, ensuring the provision of access to banking for the un-banked, working to ensure that banking is made more affordable for the general public, and keeping the South African banking industry 'World Class' through effective international compliance (Tshabalala, 2005). It is doing this by the use of financial regulation.

1.1.4 Intention of regulation

Strong and sustainable economic growth requires a strong banking system and a strong and independent bank supervisory system is critical to the health of the banking system (Guynn, 1997). Gill Marcus, former Deputy Governor of the Reserve Bank, in the foreword to the book Financial Regulation in South Africa (Falkena, Bamber, Llewellyn and Store, 2001) goes as far as to state that an efficient and effective regulatory system is core to a nation's economic wellbeing. However, the banking regulation can be utilized for more than just ensuring the stability of the banking system. It can also be used to steer the industry in the direction required by economic policy. By the introduction of certain policies and the use of financial regulation, the government is focusing the attention of the banking sector on the further stimulation of the enabling environment to foster faster private sector development and drive higher economic growth. The South African finance minister, Trevor Manuel signaled this intention in July 2005.

> We must also bring about changes designed to address past inequities and protect the most vulnerable consumers of financial services. In some areas, this has resulted in reform of the legislation, such as the National Credit Bill and the planned changes to Retirement Fund regulation. But it is also morally and economically imperative for the sector itself to come forward with a proactive response to the problems of competition, disclosure and consumer protection identified in the Banking and insurance sectors (Manual, 2005).

The regulations, detailed in the introduction above, have been introduced in order to achieve this objective.

1.1.5 Cost-benefit of the regulation

Each of the government regulations seeks to contribute towards achieving the government objective of the enabling environment. The regulations aim to ensure that benefits such as stability, depositor protection, efficiency, competition and consumer protection (Sprong, 2000) will provide a positive contribution to the economy and the financial services consumers. If effectively achieved, these benefits will sit on the positive side of the regulatory equation, contributing to the enabling environment. However, the negative side of the equation must be considered. As with all financial initiatives, there is a cost associated with the generation of the benefit. It is imperative for the ultimate goal of achieving economic growth that there is a positive Cost-Benefit for each regulation and that, in total, the benefits side of the regulatory equation outweighs the costs.

1.1.6 Stakeholders

There are a number of stakeholders affected by this regulatory environment. They will be affected by the regulations in different ways. Given the government intention of economic growth, the largest group of stakeholders is South African society which will benefit from the economic growth if the effects of the enabling environment are achieved. There are two groups of stakeholders internal to the banks that are affected. The bank is a commercial entity and has shareholders that own the enterprise. Shareholders require a financial return on their money invested in the bank and are major stakeholders as this return is affected by the cost of the regulatory environment. The management of the bank represent the shareholders and are tasked with achieving this return. They are stakeholders as they are tasked with compliance to the regulations and responsible for the implementation of this compliance. The final group of stakeholders are the customers of the bank. The compliance costs along with operational costs are factored into the pricing of banking products. If these compliance costs increase, the cost of the products is likely to increase, adversely affecting the customers.

1.1.7 Research problem

The government's intention is to use regulation in the banking industry to create the conditions of an enabling economic environment. This regulation will accrue benefits to various stakeholders in the economy but will also result in costs being incurred by certain stakeholder groups. To achieve the objectives of the enabling environment, it is important that these benefits exceed the costs.

In order to determine if the government's goal will be achieved, it is necessary to understand how each of the regulations contributes towards the enabling environment and what element of the environment each one supports. Once this understanding of the fit between the legislation and the government objectives is achieved, the expected benefits and costs of each of the legislative elements must be identified and compared to determine whether the benefits are likely to exceed the costs. Finally it must be determined which groups of stakeholders will benefit from the regulation and which will incur the cost to draw conclusions on whether the benefits are likely to be accrued as intended.

1.2 Purpose of the study

The research will aim to understand:-

- The purpose of each of the individual pieces of legislation and how each may contribute to the enabling environment;
- The specific benefits and components of costs of each legislative element and which stakeholder groups will accrue the benefits and incur the costs;
- Whether the benefits accrued from each legislative element will exceed the costs incurred; and
- Whether the regulation in South African banking is aligned towards creating an enabling economic environment.

2 Literature review

2.1 Introduction

As the communications and technology advances, which started in the latter part of the last century, link the world in real time and shorten distances, the forces of globalization are driving change in the commercial and financial marketplace. Increased competition, the high mobility of investment and labour, and active, deregulated international financial markets are changing the macro environment of business and altering the context in which business operates (Desai, 2001). Regions, countries and multinational and local business are all competing on a global level and no longer enjoy the benefits of being isolated in a particular market, economy or geography.

As a new and developing democracy, South Africa is a country that must adjust to this environment and compete globally. To achieve this, it is important that the economy shrugs off the legacy of the apartheid past and becomes globally competitive. This imperative is appreciated by the new government and a set of developmental objectives have been formulated to drive the economy towards growth. Within this plan, business has an important part to play in the achievement of the objectives and banks, as facilitators of business growth, are integral to ensuring the achievement of the development objectives. A strong banking environment will create an enabling environment to facilitate private sector growth and ensure that the growth requirements of the government are achieved. Banking regulation has a major part to play in the creation of this enabling environment and how effective the regulation is in creating the enabling environment will determine the extent to which the government's development objectives will be achieved.

In order to contextualize and understand the research problem it is important to review the macro environment in which South Africa is operating, understand business and the banking system's role in society and define the concept of an enabling environment. This provides the background to understand how the government has planned to stimulate the economy, and how regulation in banking will assist with the development of a strong banking sector reinforcing the enabling environment to provide economic growth. Finally, the available cost-benefit measurement methodologies must be reviewed to understand the mechanisms available to measure the effects of the regulation.

2.2 The macro environment of business

To fully understand any problem, reviewing the influences of the macro-environmental factors is important. Macro environmental factors influence rather than directly affect any situation and will impact how a problem is resolved. The environment affecting South African banks can be analyzed in three contexts, the global environment, the regional environment and the changing landscape of South Africa.

2.2.1 Global environment

Bracken (2005) asserts that the global environment is affected by two deeply linked factors, economics and politics.

Economically, the major factor is globalization. Globalization is the continuation of the long-term process of a worldwide industrial revolution driven by advances in information and communications technology. It involves the cross border activities of companies including international investment, trade and collaboration. It is not a new phenomenon (Mboweni, 2000). The process can be traced back to the 17th century but really accelerated in the last third of the 19th century with the invention of the transatlantic telegraph (Gray, 2005). It slowed during the 20th century mainly due to the impacts of the two World Wars, the Great Depression, the Cold War and the rise and fall of the many ideological and political doctrines that impacted the global environment during the 1900's.

According to Desai (2001), the full arrival of globalization occurred in 1989 with the destruction of the Berlin wall. Since this defining event there has been major technological progress in transportation and communication and enhanced information awareness and processing that has shortened distances and linked the world in real time. These factors have created an environment stimulating new products and innovation, integrated national markets globally and caused these markets to become so interdependent that they have changed the way in which economic activity takes place (Mboweni, 2000). The obstacles to free trade have been eliminated, facilitating the sale of goods across national and regional boundaries. Capital markets have been deregulated allowing the faster transfer of capital, active foreign exchange markets have increased global financial speculation and the emergence of global media networks have fashioned a global consumer culture (Desai, 2001).

As a consequence of this integration, governments have a reduced ability to use domestically focused policies to deal with problems in local economies (Mboweni, 2000) and there is an increased marginalization of economies reliant on intergovernmental aid especially in Sub-Saharan Africa (Desai, 2001) which, although not directly, affects the South African economy. Other adverse effects for South Africa are the increased volatility of foreign exchange and financial markets, the rapid industrialization of Asia, the displacement of manufacturing from the West to the East and the dematerialization of industrial products. This ‘shrinking’ of the world economy, coupled with the rise of some of the emerging economies, such as India and China, to prominence means that in order to find a place as a successful nation, South Africa has to become competitive in the world economy.

Politically, the world has moved towards capitalism and democracy. While in the 1970’s and 1980’s prospects looked grim for democracy and there were questions as to whether US style democracy was able to handle the challenges of the day, democracy today is entrenched, to a greater or lesser extent, in 120 countries (Bracken, 2005). Capitalism has moved along with this democracy. Capitalism is defined as the movement of goods and services by market allocation; extensive, clearly enforceable private property rights; and a complex financial system (Bracken, 2005 quoting Schumpeter). The movement to capitalism is clearly seen in the reform of many of the emerging markets since 1990. The deregulation of the Indian economy, the economic reform in China and the removal of, what Bracken calls ‘the insulating regulatory structures’ in Latin America, have all resulted in the movement of approximately 3 billion people to capitalism as defined by Schumpeter.

2.2.2 Regional environment

South Africa constitutes a major part of the region commonly known as Sub-Saharan Africa. Although the most advanced country in the region, South African is seen internationally as part of Sub-Saharan Africa and is therefore impacted to some extent by the regional macro issues. According to Ali-Dinar (1995), Sub–Saharan Africa's development is limited by a number of political, economic and social constraints. Politically, Africa has serious issues with stability. Although, even in Africa, the global political shift towards democracy is having an effect, African politics still struggles with the problems of one-party rule, human rights violations, interregional and inter-ethnic conflict and a lack of tolerance of minority groups. This projects an image of decline and instability (Herbst, 2005) that is not conducive to investment. Economically, Africa also has many faults. The majority of African countries do not have adequate macroeconomic frameworks. They suffer from a chronic shortage of foreign exchange, have an extremely high external debt burden, offer low rates of return and have inefficient financial sectors. These weaknesses limit the investment potential of the region and result in a low level of foreign direct investment (Ali-Dinar, 1995). Finally, socially, Africa has some substantial constraints. In most of the countries the infrastructure is inadequate and the roads, health services and utilities cannot support the population. This is further exacerbated by the lack of human capital in these countries and the natural (e.g. drought) and man-made (e.g. conflict) calamities that are experienced in Africa, inhibiting its ability to attract foreign direct investment.

2.2.3 The changing South African landscape

In 1994 the African National Congress (ANC) won the first truly democratic elections in South Africa signalling the end of 48 years of Apartheid rule. The ANC inherited a country that was politically, socially and economically unstable (Towards a ten year review, 2003). The legacy of the Apartheid system was a political structure geared to perpetuate a strict racial hierarchy disenfranchising the majority, a social environment in which the majority of the population were under-educated, unemployed and poverty stricken and an economy isolated by sanctions with declining growth, ballooning public sector debt and companies that, due to the import substitution industrialization, had no ability to complete in global markets.

At the time the ANC took over the government it needed to create three types of change viz. Governance, Social and Economic. The Apartheid political structures would have to change and a new constitution would need to be created to underpin the future political dispensation. The state apparatus would have to be transformed and all areas of policy recreated under the principles of a non-racist, non-sexist democracy. Socially, the agenda had to move towards poverty alleviation and redressing the imbalances in society especially in education, healthcare, housing, and essential services. Underpinning this change would have to be a solid economic foundation. The political and social change would be difficult if it was not supported by fundamental economic change. Economically, the government had to ensure job creation, the elimination of poverty, the reduction of inequality and an overall growth in the wealth of the country (Towards a ten year review, 2003). In 1994, sustainable economic growth was key to the future of South Africa.

South Africa has changed substantially in the 12 years since its first democratic elections. Politically, major change has occurred to reconfigure South African society from the Apartheid framework to a non-racist democracy (Towards a ten year review, 2003). Critical to this change was the introduction of the new constitution and legislative framework. The new constitution was adopted in 1996 and is often described as one of the most advanced and progressive constitutions in the world with the aims of transforming society and responding to the history of inequality and oppression (Jagwanth, 2003). The new legislative framework has been created by means of 789 new laws or amendment acts introduced since 1994 and together with the constitution, have created a strong democratic environment for South Africa (Towards a ten year review, 2003).

Economically, the most notable change that has occurred is the stabilization of the macro economy in the first decade of democracy (OECD, 2004; Moolman, 2005). The economy has achieved a level of stability not seen in 40 years (Towards a Ten Year Review, 2003). This stability has resulted in permanently lower inflation, currently in the middle of the 3-6% target range, interest rates that have declined substantially and stabilized and a currency that has strengthened. South Africa is experiencing the longest business upswing on record which has resulted in the average economic growth rate improving from a negative growth rate pre 1994 to an average of 3.2% between 1994 and 2005 (Laubscher, 2006). However, this level of economic growth is not enough. The country requires this growth to be sustained in order to ensure that the remaining problems of high unemployment, poverty, crime and HIV Aids can be addressed more effectively (Gouws, 2006).

South Africa is faced with major social challenges. These challenges include addressing high unemployment, poverty alleviation, the provision of essential services, development of housing and the threat posed by HIV/AIDS. Unemployment has been declining over the past couple of years (IMF, 2004) but although the trends are encouraging, at 26.5% in March 1995, unemployment remains a major social issue (Gouws, 2006). In 2001, the Human Sciences Research Council estimated that 57% of individuals in South Africa live below the poverty line (Schwabe, 2004). This was unchanged from 1996 and since the report not much progress has been made, presenting a major social challenge. The provision of essential services such as education, healthcare, water and sanitation are critical to improving the human capital of the nation (Towards a Ten Year Review, 2003). Whilst there has been some improvement over the last 10 years, major advances in the management of these social and education systems are necessary (OECD, 2004). Finally, South Africa has the highest HIV prevalence in the world (UNAIDS, 2004). A concerted effort is necessary in South Africa to mitigate the social and economic effects of this epidemic.

2.3 The role of business and banking in society

In order to study the effectiveness of the South Africa enabling economic environment, it is important to understand the role of business and, more specifically the role of banking in society. This understanding will provide part of the benchmark against which to measure the enabling environment.

Bracken (2005) describes business as the greatest force of change in the modern world. He asserts that, unlike most social institutions such as the military, the state and even education, which have been designed to thwart change, business is by its very nature designed to produce change. It is a gateway through which social, political and economic change takes place and is central to the development of an economy. He concludes that business and the development of management capability, more than government or NGO's, have a large role to play in the change in South Africa.

Handy (2002) agrees with this role of change agent. He believes that business is an active agent of progress though its activities of creating new products, spreading technology, raising productivity, enhancing quality, and improving service. He argues that the current US stock market capitalism, where the ownership of companies is being replaced by the investment in companies, is shifting the purpose of companies towards a 'purely for profit' motive. In his view, the role of business is not just to generate profit to increase shareholder value, but to generate profit to do 'something' which is the real justification for the business. He quotes Packard as saying that "….a group of people get together and exist as an institution that we call a company so that they are able to accomplish something collectively that they could not accomplish separately" (Handy quoting Packhard, 2002, p54). He believes in the European model where a company is regarded as a community whose members have legal rights. This drives an equity culture and results in companies paying greater heed to the long term needs of stakeholders other than the shareholders.

There is a move in the global business community to accept this role of change agent in the development of the greater community. John Browne, CEO of BP, believes that because business can produce technological innovation and deliver genuine progress, it is essential to sustainable development and must generate this development for its own survival (Browne, 2000). The World Council for Sustainable Development (WBCSD, 2006) and Prahalad and Hammond (2002) agree with this view. As a coalition of 180 international companies, the WBCSD includes in its manifesto, as the purpose of business, the provision of affordable goods and services to a broad population base whilst addressing the world's major challenges. It also includes uniting the interests of business and society at the deepest level, helping society to prosper and ensuring its actions are substantial and sustainable whilst remaining profitable. The manifesto concludes that a measure of shareholder value is successful delivery to society and that this contribution must be delivered through the core business of these companies and not through philanthropic programs. Prahalad and Hammond (2002) argue that there is a huge neglected market in the poor of the developing world that needs to be served. Through the direct and sustained involvement of multinational companies, they believe that prosperity can be brought to these regions in a manner that is profitable for the companies providing the services.

Economically, business development is seen as a primary vehicle for the creation of economic growth. Calamitsis (1999) lists this element as top of the agenda for sustainable growth in sub-Saharan Africa. He asserts that business has a larger impact on growth than government investment. Mboweni (2000) also supports this view that the domestic private sector is playing a far more important role in the economy of most countries including China, Russia and other developing countries.

This argument defines the role of business as one of a change agent working profitably towards the achievement of economic benefits for both its shareholders and the society in which it is based. Financial service companies, as businesses in this private sector, inherit this role and have a specific responsibility within the role. This responsibility can be defined both on a macro and microeconomic level (Hawkins, 2003a).

In a macro sense, the financial system is required to keep a fragile, fractional reserve system reasonably stable. This stability insulates the economy from financial crises such as a run on the bank and avoids adverse economic effects and a loss of confidence in the monetary system (Hawkins, 2003a; Metcalfe, 1999). Also of consequence in the macroeconomic role of the financial system is the facilitation of credible monetary policy. The effects of the macroeconomic policies in a country are transmitted to investment by the financial system. A weak financial system can inhibit the ability of a country to use monetary policy to affect economic growth (Guynn, 1997)

In a micro sense, the financial system's role is financial intermediation. This function consists of efficient allocation of resources, the mobilization of savings and the facilitation of the exchange of goods and services (Hawkins, 2003a; Levine, 1997). Lending is required to finance the capital projects necessary for the creation of economic growth. The efficient allocation of resources via lending is important as it ensures that the best use is made of the available financing. "It is the ability of banks to influence the rate of investment through financial provision that gives them a key role in the economy" (Hawkins, 2003a quoting Keynes, 1971, p6).

The mobilization of savings is also economically important. A fundamental economic reality is that in aggregate, savings have to equal investment (Skilling, 2005). Savings is made up of both international capital and domestic savings. However, international capital results in external debt and additional cost whereas savings is free. For emerging countries, such as South Africa, that require the financing of large investment to achieve growth, high levels of savings are beneficial as they will result in less external debt and lower costs, providing higher economic growth. The financial system enables this pooling of savings.

Finally, the transactional infrastructure created by the banks in the financial system facilitates the exchange of goods and services. By intermediating between parties, the banks create the ability for these parties to make financial arrangements (Levine, 1997). Inherent in this function is the provision of banking services. Without these services the facilitation breaks down and this inhibits the business development and ultimately economic growth (Ali-Dinar, 1995). The provision of these services is one area where banks can make a large difference at the lower end of the market. Low end banking services have the effect of bringing people into the mainstream economy by giving them the ability to transact and encouraging them to save. The banks have a significant role to play in these under-invested communities.

2.4 Defining an enabling economic environment

The term enabling economic environment is widely used by policymakers and practitioners. It refers to the set of conditions which affect the behaviour of the private sector (Kirkpatrick and Piesse, 2001). An environment can be termed enabling when it provides conditions that encourage the growth of private sector activity and enterprise development and place the economy on a long-term, sustainable development trajectory. Calamitsis (1999, p. 9) describes it more generically as "an overall environment within which sound economic and financial policies can have the best prospects of success." This environment should especially focus on the development of small and micro-enterprises as a means of promoting employment, increasing output and alleviating poverty. In their research comparing the enabling environments of countries in Central Europe and Africa, Bannock, Gamser and Juhlin (2003) showed that the policymakers in Central Europe have created higher economic growth than their counterparts in other countries through the improvement of conditions for their entrepreneurs.

The conditions necessary for the growth and development of the private sector are comprehensively detailed in the literature. Calamitsis (1999) and Bannock *et al* (2003) believe that achieving macroeconomic stability by sound fiscal and monetary policies is a key element creating realistic exchange and interest rates in the environment. Calamitsis (1999) focuses on fiscal consolidation including strong tax and customs administration and the reprioritization of spending to generate more resources for social and developmental expenditure and asserts that the resultant reduction of budget deficits and bank borrowing provide greater scope for the bank financing of the private sector. Both Calamitsis (1999) and Kirkpatrick and Piesse (2001) cite a system of good governance as necessary to create and sustain this environment. Governments need to ensure full accountability with strong controls, legally accepted accounting standards and well established and enforced corporate governance. Also fundamental is transparency in policy making, implementation and the management of public resources with regular, full disclosure providing legitimacy. Broad stakeholder involvement should be encouraged to create an environment of shared responsibility and the government operations should be conducted in an irreproachable manner with all corruption and cronyism eliminated.

Focusing more specifically of the small and micro enterprises, Bannock *et al* (2003) assert that the enabling environment must facilitate business by creating the institutional machinery to deal with the private sector in a co-ordinated and efficient manner. Government must implement policy to stimulate formal sector activity by reducing the barriers for the informal sector to move to the formal sector and lowering the cost of operating legally. Once this private investment has been facilitated it is important that the environment protects the rights of these investors. As such, a strong legal framework is required to safeguard the property rights and ensure the enforceability of the laws of contract.

Socially, any environment that wishes to maintain growth and reduce poverty will require an increase in the quality and quantity of high-priority services such as healthcare and education. Integrated with these services is the building of administrative and managerial capacity to ensure that both the civil service and private sector have effective individuals to implement the required initiatives.

Central to the creation of all these conditions is the reform of the financial system. As detailed in 2.3 above, banks create the infrastructure to facilitate the macroeconomic policy and mobilize savings to create financial resources for investment. They also stimulate the private sector by efficient allocation of financial resources, and provide transactability between business counterparties. An enabling environment requires a financial system that integrates these elements to create a stable competitive market environment controlled with a system of good corporate governance.

A successful enabling environment therefore has conditions that ensure macroeconomic stability, good governance, co-ordinated formal sector activity with low barriers to entry, a strong legal framework, improving social conditions and a well developed financial system.

2.5 Government development objectives

In 1994 the ANC was elected as South Africa's first truly democratic government. After the 48 years of the Apartheid rule, the country was segregated, along racial lines, into a dual economy. On one side was a developed, white dominated, prosperous industrial and commercial infrastructure and on the other a poorly equipped informal sector characterized by an uneducated workforce and underdeveloped private sector (RDP, 1994).

The key economic objectives of the government when it took office were job creation, the elimination of poverty, the reduction of inequality and the overall growth of the wealth of the country (Towards a Ten Year Review, 2003). These policies were established in the Reconstruction and Development Program (RDP). The intention of the RDP was to create an integrated, coherent socio-economic policy framework that would mobilize the country's resources towards the creation of a new, successful democracy. Economically, the RDP sought to enable the fundamental principles of democracy, participation and development in the economy. Reconstruction and development was to be achieved through the leading and enabling role of the state, a thriving private sector, and active involvement by all sectors of civil society which, in combination, would lead to sustainable growth (RDP, 1994).

The RDP was followed by a more comprehensive economic strategy called Growth, Employment and Redistribution (GEAR). This policy sought to achieve the four goals detailed above, not by nationalization and state control as was the pre-1994 ANC shadow economic policy (Fine, 1994) but by macroeconomic stabilization and the creation of an enabling economic environment. It elaborated upon the notion of macroeconomic stabilization that was inherent in the RDP and recognized that the considerable economic progress made during the successful transition was not sufficient to reverse the unemployment crisis, provide the resources to expand social service delivery and yield sufficient progress towards the equitable distribution of income and wealth (GEAR, 1996). More needed to be done to deal with the inherited fiscal crisis and well as difficulties experienced at the time with currency volatility and low investor confidence (Towards a Ten Year Review, 2003).

During the period to date, this focus on macroeconomic stability has paid off as it has addressed and successfully improved the overall economic environment, ensured stable, low inflation, low interest rates, a stable improving currency and stimulated high economic growth (Grandes and Pinaud, 2004; Moolman, 2005; Gouws, 2006). The 10 year review of the economy in 2003 revealed a decline in the budget deficit from 9.5% of Gross Domestic Product (GDP) to 1%; a fall of public sector debt from 64% of GDP to 50% and the reduction of the net open forward position from $25b to zero. The report stated that this type of macroeconomic stability has not been seen in the country for 40 years. However, the same report noted that the growth in wealth, although steady, was unspectacular in comparison with most developing economies. The same disappointing trend was noted with high unemployment further exacerbated by a shortage of suitably skilled workers causing a constraint on expansion. The report concludes that due to the lack of skills, the exchange and interest rate volatility, the high cost of inputs, lack of competition in the domestic market and poor international investor perception of Africa, higher rates of investment are not materializing. It adds that there is a great opportunity to better use the country's infrastructure to provide low cost services and add more value to the processing and manufacturing sectors.

Against this backdrop, the benefits of an enabling environment start to provide the answer. With the stable macroeconomic environment in place, the development of some of the other enabling conditions will progress the economy forward towards addressing these issues. The intention to further develop the enabling environment can be seen in the banking industry. The regulations that are currently in formulation and implementation are not randomly initiated but are part of this holistic reform plan formulated to address the major issues of poverty alleviation and economic growth (Pennington, Lundy and Bowes, 2004). To further develop the banking industry and thus the enabling economic environment, the government intent is to stimulate four areas. Direct and indirect government actions are stimulating increased competition, ensuring access to financial services for the previously un-banked, pushing for the reduction of the cost of banking services and driving compliance to the international banking standards (Tshabalala, 2005).

Through the creation of competition, the government is forcing the cost of funding down and trying to facilitate the efficient allocation of resources in the private sector. Through banking the un-banked and reducing the cost of banking services, the government's intention is to bring more people into the mainstream economy and improve the overall wealth of the nation. Finally, the adherence to the international banking standards will provide the good governance required as a condition in the enabling environment and go some way towards improving the negative perception of international investors. By these actions, government intends to ensure a well managed financial sector providing accessible banking that is affordable to the general public and is seen as world class.

2.6 The intention of financial regulation

As major players in the macro-economy, the custodian of wealth and the facilitators of financial transitions, banks pose a threat to the very growth that they need to stimulate. Irresponsible banking can result in crises that can adversely affect the entire economy. Caprio and Klingebiel (1996) have identified a number of emerging markets in which losses resulting from bank crises have exceeded more than 10 percent of GDP and Goldstein and Turner (1996) have found that banking crises in developing countries, where the banking system is less developed, have been far more severe during the past 15 years that those in industrial countries with developed banking systems.

While a bank is a profit-motivated business and managed with a view to generating a reasonable return for its shareholders, it is apparent from the above discussion that there are also strong public interest considerations inherent in the operations of banks. Four factors, resulting from the major banking functions, are, because of the public interest considerations, responsible for a high degree of regulation being imposed on the banking industry (Wiese, 1994). Firstly, Wiese explains, as banks are the custodian of the general public's savings, the safety and availability of these funds is essential to the stability and efficiency of the financial system. Secondly, the banks are responsible for the allocation of public funds to productive users within the economy to make the most efficient use of the nation's scarce savings. Thirdly, the banks are the major transmission mechanism for monetary policy forming a conduit between the central bank and the economy. They are required to transmit the impulses of monetary policy to the economy without friction or delay. Finally, the banks provide a mechanism to facilitate the exchange of goods and services. This payment mechanism must be reliable and efficient if it is to support a well functioning economy.

Together, these factors make the banking system an indispensable component of the financial system providing a vital role in the social and economic development of a nation and allowing businesses and individuals to achieve their financial goals (Bond, 2005). This important role, however, makes it a potential source of systemic instability within the economy. In a free market system, this systemic risk brings with it the possibility of economic crises which must be avoided if the economy is to be successful. Banking regulation provides the mechanism to manage this risk and is intended to ensure stability in the banking system, protecting the economy from potential crisis.

The use of the financial system to stimulate growth has been discussed in detail in 2.5 above. It is an effective tool that can be used in the creation of an enabling economic environment. However, in developing countries, the profit motive of the banks may conflict with this development imperative. Development may require the provision of unprofitable banking services which are detrimental to the business and shareholders but provide a positive effect to the overall economy or society. In this case, the required positive economic effects will not be generated by free market, capitalist forces and will have to be incentivised or legislated. Banking regulation is again a mechanism through which this can be achieved (Kirkpatrick and Piesse, 2001).

Also inherent in financial regulation is the compliance of the regulator with international norms and standards. Banking regulation can enforce standards on the various aspects of the operations of banks and ensure that the activities of South African banks comply with international standards (Hawkins, 2003a). This compliance not only enhances the reputation of the country in the eyes of investors but also creates the good governance condition of the enabling environment.

In their analysis of South African financial regulation Falkena, Bamber, Llewellyn and Store (2001) summarize these intentions. They assert that the philosophy of regulation is shaped by the norms and conventions of the financial communities, the ideologies of the political authorities and the role and operation of the financial markets. Per this definition, the intention of banking regulation is to enforce internationally recognized standards to ensure the system operates under conditions of good governance, shape the activities of the banks in the system to produce the required economic consequences and ensure the continued successful operation of the banking system.

2.7 Cost-benefit of banking regulation

Regulation is not always accepted as necessary by business. Handy (2002) describes the rationale behind the argument of business against regulation. Business believes, he explains, that passing laws and enforcing regulation constrains the way business operates. Dreyer and Weinstock (2006) argue that the cumulative effect of the numerous regulations create a hidden regulatory 'taxation' that is past on to the consumer. "Regulations are like snowflakes. Each one by itself may not be much, but when you add it all up, it could crush the building" (Dreyer and Weinstock, 2006, p99). Falkena *et al* (2001) assert that the regulation on an operational level should be both effective (achieve the objectives) and efficient (be cost effective in the use of resources). The concept of efficiency has an important influence on this particular study highlighted in the following quotation:

> There is also an important economic dimension in that regulation should not impose unwarranted costs on the economy and consumers nor impair the efficiency of financial markets. This dimension also considers whether the objectives could be achieved in less costly ways. These considerations can be judged following cost-benefit analyses of regulatory requirements. There should always be an awareness that specific regulation can inflict damage if it is either flawed or incorrectly applied. In such a case it would actually impair the working of the market mechanism and produce perverse results – i.e. counter the objectives of regulation (Falkener *et al*, 2001, p1)

Therefore, of primary importance in the objectives of financial regulation is the efficiency of the regulation. There is a balance to be achieved between the benefits provided by the regulation and the cost of implementing such regulation. Establishing the cost-benefit of regulations is important in ensuring that the policies do not inflict damage and work counter to the regulatory objectives (Falkena *et al*, 2001).

Three methods can be identified, in the literature, to assist with this cost benefit review. Firstly, Cost-benefit analysis (CBA) is used in the United Kingdom and United States to compare new policy options (ex ante CBA) or evaluate existing policies (ex post CBA) and conclude on the cost effectiveness of these policies (Financial Services Authority, 2000). It is a practical and rigorous process of identifying, targeting and checking the impacts of regulatory measures and can provide information useful in regulatory decision making (Alfon and Andrews, 1999). CBA seeks to understand the benefit and cost impacts of a particular policy or regulation. It focuses on the 'big picture' impacts of policy variations to limit efficiently the analysis required. The analysis of the impacts are more revealing if quantitative analysis is performed but this is often not possible and therefore CBA is largely qualitative in nature. It involves defining market impact categories and, within these categories, assessing the cost and benefit impacts and understanding the distribution of the costs and benefits between the different stakeholder groups. The list of impact categories is generally not exhaustive or definitive but is sufficient to obtain an overall judgment of the impact of the policy or regulation (Financial Services Authority, 2000).

Secondly, also used in the United Kingdom is Regulatory Impact Assessment (RIA). This derivative of CBA considers the ex-ante impact of regulation based on forecasts and stakeholder surveys. RIA does not replace other decision methods in the regulatory process but strengthens the quality of debate and understanding in the decision making process. It considers four outcomes viz. the necessity of the new regulation, whether it is aimed at the correct areas, the appropriateness to the issue under consideration and the compliance levels that are used. By considering these outcomes, RIA improves the understanding of the benefits and costs of government action, can integrate the linkages and impacts of multiple policy objectives, improves transparency and consultation and increases government accountability (Kirkpatrick and Piasse, 2001).

The third approach is that of calculating return on investment. When the costs are exceeded by the benefits, a return on investment can be said to have been achieved. The ROI measure, however, deals with monetary units and can be calculated when both costs and returns are in the same format by deducting the costs from the returns and calculating a percentage (Phillips, 2003). However, as most of the costs and benefits in the case of banking regulation are perceptions rather than numbers, they need to be loosely interpreted so that the different variables can be weighed up against each other and not deducted from each other as in a financial ROI (Carmichael and Sutherland, 2005).

Each of these three methods evaluates regulatory CBA with a slightly different approach. A study of the benefits and costs of banking regulation can utilize all three methods to provide a comprehensive view of the impacts of the regulation.

2.8 Conclusion

South Africa is a developing democracy in an underdeveloped region facing the globalization of the international economy. In order that the country's development continues to advance in this global economy, economic growth is required. This growth requires both macroeconomic stability and an enabling economic environment. This enabling environment must provide the conditions for the private sector to develop into a major engine of economic growth. The financial system and more specifically the banks have a major role in assisting to create this enabling environment. Banking regulation is key to ensure that the banks are incentivised to play this role in an efficient manner without the introduction of systemic risk. Understanding the cost-benefit of the new banking regulations in South Africa will indicate to what extent the banks' role in the creation of the enabling economic environment may be achieved.

3 Research Questions

Due to the exploratory nature of the study, research questions, derived from the purpose of the research and supported by the literature review, were used to define the specific research problem.

The following questions were formulated from the research problem:

Table 1: Research questions

#	Question
1	What is the purpose of each of the legislative elements and how may each element make a specific contribution to the enabling economic environment?
2	What are the specific benefits and the components of cost of each of the legislative elements and which stakeholder groupings will receive the benefit and incur the costs?
3	Will the overall benefits accrued from each legislative element exceed the costs incurred?
4	Is regulation in South African banking aligned towards creating an enabling economic environment stimulating economic growth?

4 Research Methodology

This study was exploratory and qualitative in nature and was conducted in 2 phases. Phase 1 consisted of secondary documentary research and phase 2 of primary, interview-based research. This triangulated research approach was taken to ensure the credibility and validity of the qualitative analysis. By combining the different perspectives obtained from the results of the documentary research and the perceptions of multiple observers obtained in the interviews of expert commentators, this triangulated approach mitigated against the weakness or intrinsic biases that would have come from single method, single-observer or single-theory study.

4.1 Phase 1: documentary research

4.1.1 Research methodology

Phase 1 of the research was focused on a *de jure* analysis of the legislation enacting each of the regulations and a review of the commentary and perceptions of some of the experts in the field of banking regulation. The analysis was performed to create a base for comparison with the views that will result from the phase 2 research detailed in section 4.2 below.

To complete this analysis, documentary evidence relating to the South African banking regulatory environment was reviewed. For each of a selection of the relevant legislative elements, an overall definition of the regulation and its purpose in the regulatory environment was documented. Its contribution to the enabling economic environment was then determined to understand what components of this environment the legislative element supports. Finally, the expected benefits and components of the costs were determined from the available documentation to understand the impact on the stakeholders of the implementation of the legislation. The stakeholders were defined as follows:-

- **Bank Customers**: The existing customers of South African Banking Institutions;
- **Banks**: The management of the South African Banking Institutions representing the legal entity that is the Banking Institution;
- **Shareholders**: Investors who have made an investment in the shares of the Banking Institutions; and
- **Society in South Africa**: The inhabitants of South Africa that will stand to benefit from the economic improvements facilitated by the enabling environment.

The benefits and costs were clustered into these categories.

4.1.2 Unit of analysis

The unit of analysis used in this phase of the research was an individual piece of banking regulatory legislation. The units were composed of an act of parliament, a draft bill or a charter document.

4.1.3 Population of relevance

The population of relevance was all pieces of regulatory legislation that have been introduced into the banking environment in the past 5 years.. If the definition of legislation was strictly enforced, the population would have been limited to Acts of Parliament. However, in the period under review there have been other regulatory interventions self-imposed by the banking industry that are extremely relevant to this study. Therefore, for the purpose of defining the population of relevance, the definition of legislation has been extended to include these other pseudo-legislative elements.

4.1.4 Sampling method and sample size

The sampling method used was purposive, non-probability sampling. Kerlinger (1986) explained purposive sampling as a type of non-probability sampling, which is characterized by the use of judgment and a deliberate effort to obtain representative samples by including typical areas or groups in the sample. In this sample, because the population was small and highly specialised, the use of purposive sampling was the most effective. The resulting sample selected included all major regulatory legislation within the defined population. The degree to which legislation was defined as major was based on the judgement of the researcher and validated in the documentary research and research interviews.

The legislation that was selected for review was:-

- National Credit Act;
- Financial Centre Intelligence Act;
- Financial Advisory and Intermediary Services Act;
- Basel II; and
- Financial Services Charter.

4.1.5 Research instrument

No research instrument was required for documentary research.

4.1.6 Data collection

The data required for the documentary research was collected via a review of a various secondary data sources. This secondary data was sourced by a review of electronic databases such as the South African Reserve Bank and South African Government websites, discussions with the major audit firms, a detailed review of the relevant legislation and a general review of the financial press, bank releases and other related documentation.

The sources included:-

- The official version of the Act or Bill;
- Government white papers;
- Speeches by government and South Africa Reserve Bank officials;
- Reports and surveys from auditors and other commentators;
- Analyses by parties with a vested interest in the legislation e.g. Software vendors; and
- Media analyses.

No specific research or analyses relating to the purpose of the various regulations, the contribution to the enabling environment or the benefits and costs was found during the review. Therefore, the data collection focused on obtaining information that would provide various inputs into the analysis. Each of the above sources provided different perspectives on each legislative element and allowed a definition of purpose, contribution to the enabling environment and benefit and cost per stakeholder grouping to be developed. All of the above sources are included in the reference listing.

4.1.7 Analysis approach

The analysis approach required the use of content analysis to identify, extract and collate themes that were then mapped together to define high level summary of each of three research categories. Content analysis is a research technique used to determine the presence of certain concepts within texts or sets of texts. Using content analysis, researchers are able to quantify and analyze the presence, meanings and relationships of concepts and then make inferences about the messages delivered within the texts (Colorado State University, 2006).

The analysis categories were defined as:-

- **Purpose**: A high level understanding of the purpose of the legislation and how the legislation is or will be functioning;
- **Contribution to enabling environment**: The contribution that each legislative element will be making to the enabling economic environment;
- **Stakeholder benefits**: The benefits that this would provide to each of the stakeholder groups; and
- **Stakeholder costs**: The costs that would be incurred by the stakeholders due to the implementation of the regulations.

During the analysis, the documentation collected for each of the regulations was reviewed and content relevant to each of the research categories was extracted. These details were then mapped together for each category and consolidated to create a high level summary for each category. A definition for the purpose of the regulation, a description of how the regulation supports the enabling environment and a listing of the benefits and costs of the regulations were all determined from the content of the documentation reviewed. Approximately 5 hours of analysis was performed for each of the regulations.

The matrix that was used to collate the analysis of each element is shown in figure 2.

Figure 2: Documentary research data analysis matrix

1. Purpose		
•		
2. Contribution to Enabling Environment		
•		
3. Stakeholders		
	Benefits	Costs
Banking Customers		
Banks		
Shareholders		
Society of South Africa		

4.2 Phase 2: structured interviews

4.2.1 Research methodology

The intention of this phase of the research was to validate the *de jure* analysis relating to the regulatory purpose, contribution to the enabling environment; and benefits and costs of the legislative elements that were developed in phase 1. This validation was achieved through the study of the perceptions of experts obtained by structured interviews with relevant industry commentators and bank management responsible for the implementation of the regulations at a large South African banking institution.

The interviews were structured into the three major areas covered in the phase 1 analysis. An introductory discussion was included at the beginning of each interview to describe and discuss the concept of an enabling economic environment. The purpose of this discussion was to ensure that the interviewees all commenced the interview with a common understanding of an enabling economic environment. The interviews were then conducted using an interview guide that structured the questions to ensure that each of the three areas was covered for all the relevant legislative elements.

These interviews provided the data that was used to compare to the *de jure* analysis developed in phase 1 and either corroborate or contradict the phase 1 findings.

4.2.2 Unit of analysis

The unit of analysis in this phase is the opinions of an expert in the field of South African banking regulation. In this study these experts are financial commentators or bank executives and are assumed to have an good understanding of the majority of the legislative elements.

4.2.3 Population of relevance

The population of relevance in this phase is all experts in the field of South African banking regulation. This population was clustered into two sub-populations. These sub-populations are:-

- Financial commentators who have knowledge of the banking regulation;
- Bank management charged with the implementation of the regulation

4.2.4 Sampling method and sampling size

As with phase 1, the sampling method was non-probability sampling but in this phase, a combination of purposive and snowball sampling was used. However, due to the sub-populations within the population, cluster sampling was used prior to the non-probability sampling to segment the population into mutually exclusive groups. Cluster sampling divides the population into clusters or subpopulations which can be regarded as a microcosm of the entire population (National Audit Office, 1999). After segmenting the population, judgement was applied within these groups to select the sample. This sample was then extended by the use of snowball sampling. Atkinson and Flint (2005) confirm snowball sampling as valuable in studying groups located out of mainstream research in less stigmatised and even elite groups providing the ability to uncover aspects often hidden from both researchers and lay persons. This specialised group is out of the mainstream and, to some extent, elite and therefore the selection of method is supported.

To apply the triangulated research approach and support the documentary research results, five experts were selected from each of the clusters or sub-populations. Five financial commentators were selected based on their knowledge and experience in the banking industry and their ability to comment on the regulations. Five executives from the management of a ‘big four’ South African bank were selected based on their involvement with the implementation of the regulation.

4.2.5 Research instrument

The research instrument used was an interview guide, shown in appendix A, to direct the structured interviews. The interview guide was designed based on each of the research questions and structured according to the analysis in phase 1.

The guide contained the following sections:-

- **Contextualisation**: This section established the extent of the individual's expertise to understand which regulations will be addressed and explained the components of the enabling environment to ensure consistency of response;
- **Questions per legislative element**: This section established the purpose of each legislative element, its individual contribution to the enabling environment, the benefits and costs associated with the element classified per stakeholder grouping and an opinion as to whether the benefits will exceed the costs. These questions were repeated for each element; and
- **Enabling environment**: This section probed the overall understanding of how the regulations are contributing to the enabling environment.

4.2.6 Data collection

The data collected consisted of the opinions of experts in the field of banking regulation. These opinions were collected during structured interviews with each of the experts selected in the sample. The schedule of interviews conducted is shown in appendix B. The interviews followed the structure of the interview guide, starting with the contextualisation to ensure consistency in the data collection and confirm the areas of expertise of the interviewee. The extent to which the legislation was covered in each interview is detailed in appendix B. The questions per legislative element were then asked for each regulation identified as within the interviewee's area of expertise. Finally, the enabling environment section probed the perception of the interviewee regarding the overall environment being created by the combination of all the regulations. The interviews were all recorded and transcripts of each interview produced for later analysis.

4.2.7 Analysis approach

The transcripts of each interview were studied and the answers to the question on each regulatory element captured into a similar framework as was used in phase 1 detailed in 4.1.7 above. To add additional research dimensions two adjustments were made. Firstly, the respondents were asked which pillars of the enabling environment were supported by the regulation. The frequency of the votes for each pillar was recorded in the third section of the table providing a view on the focus of each regulation within the enabling environment. Second, the benefits and costs were captured into the matrix against the category of respondent. This provided the ability to understand the differences in the answers from the various sub-populations. The matrix that was used to capture the interview results is shown in figure 3. Finally, in order to understand the respondent's perception of the overall contribution to the enabling environment, their responses to this question were captured in a separate table. If a yes and a no vote were obtained from the same respondent, the vote was divided by two and added to the totals hence the decimals.

Figure 3: Interview data analysis matrix

1. Purpose
•
2. Contribution to Enabling Environment
•

3. Pillars of the Enabling Environment Supported				
Good Governance	Coordinated formal sector activity	Strong legal framework	Improving social conditions	Well developed financial system

4. Stakeholders			
	Interviewee	Benefits	Costs
Bank Customers	Commentator		
	Bank Official		
Banks	Commentator		
	Bank Official		
Shareholders	Commentator		
	Bank Official		
Society in South Africa	Commentator		
	Bank Official		

4.3 Comparative analysis

4.3.1 Research methodology

The results obtained in the phase 1 and phase 2 research were compared and combined in the analysis of results section to provide a holistic answer to the research questions. The results from the documentary analysis were used as the base for each answer. The responses from the interviews were then used to corroborate or add to the answers to provide the holistic view presented.

4.4 Research limitations

As with all research studies, there are some limitations in this study that must be recognised and the findings considered in the light of these limitations.

The study was qualitative in nature and used a triangulated approach of documentary research and focused interviews to obtain the data for the study. A number of limitations arise from this approach:-

- The nature of this qualitative research results in small sample sizes and the use of a judgemental selection method to define the sample, which may produce results that are not are reflective of the population;
- The triangulated approach may not generate complementary views, as is intended to validate the findings, but create opposing, albeit equally valid, perspectives; and
- Interviews are dependant on interpersonal exchanges which may be influenced by situational conditions at the time of the interview. Factors such as time pressures, demeanour, current circumstances and personal impact of the interviewer may influence the quantity and quality of the information provided by the interviewee.

The sample group of bank officials have all been sourced from one of the big four South African banking institutions. This focus on a single institution creates limitations to the research because:-

- A similar view generally pervades an organisation. Through the various interactions required to deal with the issue of compliance with the regulations, the entity has built up an organisational view. This organisational view will impact the personal views of the interviewees and may cause their responses to be similar.

- The regulations relate to all financial services entities. The focus of the interviews has been a banking institution. By focusing on a bank, the perspectives of other financial institutions such as insurance and fund management companies will not be included. The results from such companies may differ from the banking views.

Also, although every effort was made to contextualise the research and achieve consistency in the interview process, the functions of each interviewee and his/her perspective on the regulation may cause their interpretation of the same question to be slightly different. This results in responses that appear to be similar potentially having different interpretation depending on the function of the interviewee.

Finally, the topic of regulation is emotive and, especially in the banks, is seen to be inherently negative. However, public criticism of the regulators and focus on the negatives of the legislation by the banks can be interpreted as negative to the image of the good corporate citizen. Although confidentiality will be protected in this study, it may have been perceived by the interviewees that the results could be seen as public criticism and they may have self-censored their views as a result of this perception.

5 Results

The results of the phase 1 and phase 2 research are detailed in the tables below. Each table is headed with a table number and description and runs over a number of pages. For each of the regulations there are two tables, the first containing the documentary research results and the second detailing the results of the interviews.

The documentary research results table includes a section for each of the following:-

- The purpose of the regulation;
- The contribution of the regulation to the enabling environment; and
- The benefits and costs broken up into the stakeholder groupings to which the benefit or cost relates.

The interview results table contains the similar information but has certain additional information. This table contains:-

- **Purpose** - A comment for each of the interview respondents as to the purpose of the legislation;
- **Contribution to the enabling environment** - A comment for each of the interview respondents as to the contribution of the legislation to the enabling environment;
- **Pillars of the enabling environment supported** - the frequency of responses as to which pillars of the enabling environment are supported by the legislation. Note: each respondent could have selected between 1 and 5 of the pillars; and

- **Benefits and Costs** – The benefits and costs by stakeholder grouping further broken down by respondent category ie commentator or bank management. Where no benefits or costs were mentioned, the table cell was left empty. Where multiple similar answers were obtained, the figures in brackets indicate the frequency of response for the same benefit or cost.

5.1 National Credit Act (NCA)

5.1.1 Phase 1

Table 2: National Credit Act - documentary research results

1. Purpose
The new National Credit Act (NCA), effective 1 June 2006 aims to protect the consumer from undue risk and create a fair and non-discriminatory marketplace for lending. The NCA aims to regulate the granting of consumer credit by all credit providers including microlenders, banks and retailers and end exploitative practices by non-reputable credit providers. While consumers will see some changes in the way they apply for and receive credit, the biggest impact will be on credit providers. The NCA aims to make credit markets work by: • Promoting a fair, competitive and sustainable credit market; • Redress power imbalances between lenders and borrowers by regulation and education; • Educating customers and helping them to make informed choices; • Enforcing affordability checks and calculations in all cases; • Providing protection to customers through the establishment of a national credit regulator, a consumer credit tribunal and a debt counselling process; and • Create a fair, balanced and transparent credit market.
2. Contribution to Enabling Environment
• Provide access to credit for all South Africans by redressing the imbalances in the South African consumer credit market, creating a more efficient credit market and providing credit at affordable rates. • Stimulate business by provision of credit to small companies as part of plan to build a credit economy to meet needs of all South Africans. • Create competition by removing limitations and creating incentives to fill the credit gap and encourage new players to address the under-contested market.

3. Stakeholders		
	Benefits	**Costs**
Banking Customers	• Highly indebted excluded from further debt by credit assessment conditions. • Debt counselling process provided to assist indebted consumers. • National Credit Regulator to regulate industry and enforce NCA provisions. • Reduction of reckless lending by onerous credit agreement obligations imposed on credit providers. • Improved disclosure by credit provider in clear, concise, plain English. • Transparent rates linked to a reference rate. • Caps on charges and interest owed. • National consumer tribunal to resolve disputes. • Consumer right to be more informed and educated on lending products offered. • Greater competition provides more credit provider choice.	• Complex application process results in reluctance to make a credit application. • Onerous application results in more confusing documentation. • Increased complexity of conditions due to reckless lending provisions.

	Benefits	Costs
Banks	• Forced to improve process efficiencies reducing cost. • Easier debt collection and repossession as debt recovery legislated and occurs in uniform manner. • Compliance will improve reputational risk. • Greater certainty as to processes and procedures.	• Reduce ability to innovate in creation of new credit products. • Creates greater administrative burden. • Onerous application process requires substantial process change. • Realign end to end processing with associated system changes. • Revision of credit and product policies. • Enhance origination process to obtain more information. • Incorporate debt counselling in collection policies and processes. • Implement affordability assessments. • Extensive change management requirements. • Educate customers and train all staff.
Shareholders	• Company remains leading edge in the stimulation of business growth. • Better credit processes lower investor risk. • Investment in good corporate citizen.	• Potentially reduced returns due to costs incurred.

	Benefits	Costs
Society in South Arfica	• Provide competition in the credit market reducing the cost of credit. • Make the credit market more efficient reducing the cost of credit. • Credit provided to small companies which perform successfully producing economic growth.	• Adverse relationship with banking sector and investors.

Sources: National Credit Act (2006), Cliffe Dekker (2006), De Ridder, (2005), Hawkins (2003b)

5.1.2 Phase 2

Table 3: National Credit Act - interview results

1. Purpose
• To ensure responsible and affordable lending that does not allow consumers to get into debt traps. • To prevent misguided consumerism and reduce the exploitation of the financially illiterate population caused by unrealistic interest rates that they do not understand. • To create a standard framework that ensures consistency in the granting of credit, limits malpractice particularly in the microcredit industry and creates a level of consumer protection in the overextension of credit. • Designed to regulate miscreants in the largely unregulated microfinance sector but is a South African deviation from best practise consumer legislation using micro-loan focused legislation across the whole credit sector. It is copy paste of legislation from developed economies that is providing an over-engineered solution detracting from the self regulation that was in place. • To broaden base of access to credit and remove discriminatory requirements in respect of access to all forms of credit. • To consolidate the disjointed borrower protection which exempted the consumers that needed the protection the most. • To merge the 2 lending markets in SA, the normal banking system and the marginalised market where lending falls outside regulation and the pricing is unacceptable. Intention is to normalise and regulate the marginalised market and encourage traditional banks to move down the ‘food chain’ and up the risk curve. • Asks for basic banking requirements to be applied for the protection of the consumer, particularly the consumer that has not entered the credit market before. • To regularise the outdated legislation and stop the untoward activities of credit providers that have been taking place by providing a consolidated

view of the credit provider.

- To protect the borrowers ie consumer protection, encourage competition in the credit markets and enforce more discipline on credit providers before they can make credit available.

2. Contribution to Enabling Environment

- Avoid unbridled capitalism playing on the greed and fear of people.
- Avoidance of trapping people in debt will keep them as economically active and not marginalise them.
- May limit the high flyers but will protect the weaker consumers.
- Is providing protection to the developing middle class but at the cost of excluding the low income earners. Act has gone too far and needed a limit ie act applies to those earning less than RX.
- Consistent application of sophisticated framework that applies across the industry has restricted business practices that have, in the past, undermined a consistent playing field.
- It is not contributing as efficiently as it could due to being copied from developed countries and due to the promulgation following a poor consultative process.
- Will enable access to cash from official providers for people who will then no longer be reliant on the informal, trust based, social financial structures. Will also promote individual responsibility for credit.
- Will provide affordable access to credit and ensure that the consumers do not over borrow especially from the unregulated microfinance sector.
- Will bring all lenders within its ambit and reduce the applicable legislation to one integrated piece of legislation that is easier to understand, implement and enforce than the current fragmented legislation e.g. usury act and Exemption notice. Compliance will improve governance, remove unacceptable practices and contribute to the normalisation of banking and allow those who fell outside the banking system to enter into the formal banking system. Through lending, the NCA will build assets contributing to asset formation in the country and will assist with the distribution of assets and income.
- Adds to the sustainability of the credit marketplace by ensuring that the consumer is better informed at the time of credit provision.
- Did not go far enough to ensure that the total cost of credit is disclosed as various forms of cost result in obscure pricing preventing true comparison.

3. Pillars of the Enabling Environment Supported				
Good Governance	Coordinated formal sector activity	Strong legal framework	Improving social conditions	Well developed financial system
8	6	9	7	8

4. Stakeholders			
	Interviewee	Benefits	Costs
Banking Customers	Commentator	• Stronger relationship with bank through successful lending. • Certain section of the population will find security in the increased requirement. • More disciplined and customer friendly credit environment. • More security around the consumers credit information.	• Certain people will be excluded from credit market especially those on the fringes (5). • Flow through of costs incurred by the banks to the customers in the form of fees. • Credit exclusions will stimulate the activities of the illegal lenders lending at prohibitively high rates of interest.
	Bank Executive	• Protection of weak consumers (2). • Removal / restriction of loan sharks. • More low end consumers will 'survive' the granting of loans. • Consumers will understand more about lending costs and affordability (2). • Increases access to lending and therefore ability to acquire assets.	• Quality of information may restrict ability of customer to obtain funding. • Costs will be passed on in the product pricing – more expensive banking (3). • Higher costs of origination and collection will make cost of lending at the lower end of the population expensive and unattractive.

	Interviewee	Benefits	Costs
Banks	Commentator	• Level playing field in which to complete. • Better pricing for risk. • Stronger relationship with customers through successful loan repayment record. • Requirements are actions that banks should perform anyway and have now been institutionalised. • Legitimises the pricing of high price credit.	• High financial cost in time and management distraction. • Large foot soldier costs to reassess the existing customer base and reconsider overdraft limits (2). • Cost intensive in systems and processes to set it up (2). • Increase costs in investigation prior to lending. • Cost of the NCA should be a business as usual cost.
	Bank Executive	• Lower bad debts and more sustainable lending. • Better credit bureaux governance. • National database of information will be useful. • Refocused banks on customer centricity and creating a single customer view. • Certain elements within the act can be used by the banks to obtain benefits e.g. better pricing through the usury rates structure.	• Credit bureaux forced to expunge information that would be good for banks. • Cost to address risk of lending to a more risky element. • Large system and business process investment (2). • Additional administration of paperwork and bureaucracy. • Longer to recover debt due to collection conditions (Time value of money). • Costs will drive banks further away from banking the lower end of the market. • Large reorganisation costs in respect of systems, processes, staff in branches and training. Also contracts and forms must be rewritten and language policies revised. • Longer sales process.

	Interviewee	Benefits	Costs
Shareholders	Commentator	• Long term contribution to improved social conditions will ensure prosperity of the industry.	• Negative initial impact to shareholders due to higher cost (2).
	Bank Executive		• Not all costs passed to customer but competition will prevent total recharge and impact shareholders profits.
Society in South Africa	Commentator	• Savings culture of the country within a trustworthy financial structure will be enhanced over time which becomes available for investment. • Ongoing contribution to improved social conditions will improve country. • By reducing the illegal credit and providing better value for credit will improve the retention of cash for savings.	
Society in South Africa	Bank Executive	• Greater understanding of commitment required and increased credit history will increase the developmental borrowing e.g. home loans. • More stable lending environment. • Brings SA in line with the global	• Credit bureaux forced to expunge information reduces available information on consumer. • Economic cost of credit procedures will impinge on normal economic activity. • High cost of credit will drive bottom end consumers to 'extra-legal' lenders eroding the value of the little money that the poor has already, creating not addressing poverty and removing this money from the economy.

	Interviewee	Benefits	Costs
		trends in consumer protection. • If implemented properly, the lower end of the market will benefit from the greater knowledge of lending.	• If positives in legislation are not innovatively exploited, banking profits will suffer and the reaction will be to reduce cost through lower headcount, reducing employment in the country. • Banks could decrease their lending reversing the trend of access that the legislation is trying to achieve.

5. Do the benefits of the legislation exceed the cost?		
Yes 4	No 3	Maybe 3
• It had to be done and a good process was followed to obtain an even balance between the concerns of the industry and the government objective and this will result in long term benefits exceeding the costs. • If banks approach this in an innovative, proactive manner and take advantage of the positive provisions in the legislation benefits will exceed costs. Once the up-front costs are incurred the advantages from provisions such as the higher interest rate caps will benefits banks through higher yielding assets and the reduction of moral hazard at the lower end of the market will allow appropriate pricing	• In banking the lower end of the market, the costs of the compliance will reduce legal lending, reduce access, promote illegal lending and increase the cost of banking driving consumers away from the banks. • Over-engineered solution for a small problem. New consumer legislation and changes to the banks act would have been cheaper and more effective. It is important legislation that has been badly implemented. • If banks are not able to leverage the positive provisions through business innovation, costs will exceed the benefits. • Definitely in the short term the costs will outweigh the benefits	• Need to see all parts. • Economic cost as a whole may impinge on normal economic activity. • Problems will occur with keeping information current which is essential for this to work. • In an environment of high growth, the NCA will foster a strong financial sector leading to growth and stability and in low growth environment will compound problems as higher cost for no value. Precondition is significant growth. • Not in the short term, in the long term maybe. The culture of discipline, integrity and responsibility in not what it should be in SA and until it is improved, there is a large cost especially

5. Do the benefits of the legislation exceed the cost?		
Yes 4	No 3	Maybe 3
and will create new customers.	but over the long term we may see the benefits becoming even with the costs.	in relation to crime.

5.2 Financial Intelligence Centre Act (FICA)

5.2.1 Phase 1

Table 4: FICA: documentary research results

1. Purpose
Money laundering can be described as the manipulation of illegally acquired wealth in order to obscure its true source or nature and ensure that it cannot be traced back to the underlying crime. Anti-Money Laundering (AML) can be defined as an international activity which aims to prevent money laundering from happening; deter and detect organised crime; reduce drug dealing; deter terrorism; and maintain the reputation of the financial services industry. Traditionally banking institutions are used by money launderers to penetrate the financial system and as such are subject to Anti Money Laundering legislation. The South African legislation in this regard is the Financial Intelligence Centre Act (FICA) effective 28 November 2001. Its purpose was to establish a Financial Intelligence Centre and a Money Laundering Advisory Council in order to combat money laundering activities by imposing certain duties on institutions that might be used for money laundering purposes. The legislation requires that financial institutions must:- • Require identification of their customers by means of supporting evidence when entering into business relations; • Maintain adequate records of transactions and identification for at least five years from the date of termination of the relationship; • Co-operate with national law enforcement authorities and provide them with any relevant information requested; and • Inform the authorities of any fact which might be an indication of money laundering.
2. Contribution to Enabling Environment
• The cost of crime to any country and its economy is substantial. Crime costs include government spending on the police and justice system, private expenditure on increased security protection, the value of stolen goods, the cost of medical treatment for victims of crime and the intangible damages to crime victims, their family and the community. • Any reduction in the cost of crime would provide more resources to be deployed into the enabling environment to work towards the development of economic growth. • The combating of large scale crime by the prevention of money laundering will contribute to a reduction in the cost of crime and thus make available more resources to be applied to the creation of the enabling environment.

3. Stakeholders		
	Benefits	**Costs**
Banking Customers	• Less crime. • Creation of a more honest society. • Lower tax rate. • Discourage criminal gangs and drug dealers. • Raise levels of awareness of public as to their contribution to combating crime.	• Inconvenience of reconfirming all details for each account.
Banks	• Better knowledge of the customer through improved customer data. • Reduction in fraud. • Reduction in credit risk. • Creates more customer confidence and integrity in business community. • Reduction in reputational risk through compliance to international standards.	• Administration. • Creation and maintenance of detailed verification procedures and processes. • Verification costs of locating customers especially difficult in rural South Africa. • Modification of systems to enable the capture of customer validation status. • Development of new procedures. • High training costs including training efforts and training manual development. • Maintenance of customer records for 5 years will require substantial storage space. • Business opportunity cost of the time required for compliance.
Shareholders	• Company remains leading edge in the fight against crime. • Investment in leading edge, compliant company.	• Potentially reduced returns due to costs incurred.

	Benefits	Costs
Society in South Africa	• Reduction of crime. • Release of scarce resource from policing to be applied to development.	• Adverse relationship with banking sector and investors.

Sources: Financial Centre Intelligence Act. (2001), South Africa Law Commission (1996), O'Hare (2003), Yeandle, M. Mainelli, M. Berendt, A and Healy, B (2005), PriceWaterhouseCoopers (2003)

5.2.2 Phase 2

Table 5: FICA - interview results

1. Purpose
Prevent the use of the proceeds of crime and other enabling funds for the purpose of crime and terrorism. Know your customer to prevent money laundering and terrorism and minimise the risk of undesirable people using the financial system (3). Stop money laundering and identify illegal activity creating a paper trail to investigate illegal activity (2). Keep America happy! Control of international flows of money by terrorism. Control of cross border cash flows (2). Vital to counteract the image of South Africa as a haven for criminals and ensure that country has access to global capital. Under apartheid South Africa was highly protected. When the barriers can down, the fairly advanced economy found itself with relatively little controls and became a haven for organised crime due to advanced banking system and extremely liquid currency. FICA protects the South African banking system from abuse. FICA has absolutely no purpose in a developing economy such as South Africa.
2. Contribution to Enabling Environment
Adds a cost to the criminal activities and through preventive measures serves to inhibit crime. Regulations make the environment less attractive to organised crime. Provides legitimacy to South Africa Inc as part of the scorecard used by international rating agencies. Reputational necessity. (2)

Forces industry discipline and the execution of the basics of understanding your customer. Has ensured that the country is not cut off from the international banking system. It is largely driven by the USA who requires such legislation. It has however gone too far (South Africa is the only country except Israel that is confirming old customers). Important for the development of a strong legal framework and well developed financial system to ensure the country is not seen as an easy environment for criminal activities, increase the external reputation of the country and improve its investment potential. No contribution to enabling environment as exemptions are too low and volumes of information can never be effectively investigated and policed by the bureaucratic system that has been created, especially for bottom end consumers. Has been notably negative to the enabling environment and has created a barrier to access. The exemptions will be difficult to maintain and update. The regulations have gone further than most developed countries making the provisions unnecessarily onerous.

3. Pillars of the Enabling Environment Supported				
Good Governance	Coordinated formal sector activity	Strong legal framework	Improving social conditions	Well developed financial system
7	1	7	1	6

4. Stakeholders

	Interviewee	Benefits	Costs
Banking Customers	Commentator		• Multiple visits to bank to FICA each account wastes time. • Access barrier that has created confusion in the minds of the consumer.
Banking Custo	Bank Executive		• Cost is too high to cover all customers. Should have a limit. • Restriction on use of financial services due to limited FICA documentation available to customer (2).

	Interviewee	Benefits	Costs
			• Irritation of having to confirm details multiple times although this is more an error of execution by the banks than the result of the Act.
Banks	Commentator	• The information on the customer enables the banks to understand the customer value and risk. • System in place to protect banks from abuse.	• High personnel cost to ensure that all requirements are adhered to. • Costs are unfairly concentrated on the banks. • Short term costs to comply (2). • Damage to client relationships. • Meaningless compliance cost.
Banks	Bank Executive	• Protect banks from reputational embarrassment (2). • Bank will better understand lifecycle of customers (2). • Knowledge of customers will allow a better cross sell of products. • Richer data will allow for better direct marketing. • Should reduce the losses incurred as a result of criminal activities.	• High short term incremental/ transitional compliance costs (3). • Long term costs are not significant. • Origination costs are significantly increased. • Creativity and innovation stifled by regulatory compliance. • Systems, people training, lawyers and accountants. (2)
Shareholders	Commentator		
	Bank Executive	• Will benefit from the more creative use of the data for marketing of products.	• Higher cost reduces the return to the shareholders.

	Interviewee	Benefits	Costs
Society in South Africa	Commentator	• Adds to the financial 'health' of the country and enhances international image of the country. (3). • Increases social discipline and reduces criminal activity.	
	Bank Executive	• Extension of good judicial system. • Public image is improved internationally. • Less risk of the misuse of the banking system (2). • Major benefit is reputation that makes SA a more favourable investment destination, securing more inward investment and thereby benefiting the country.	• Restriction on use of financial services due to limited FICA documentation available. • Inability to cut costs of the banking products to an affordable level due to FICA compliance restricts access to banking services.

5. Do the benefits of the legislation exceed the cost?		
Yes 6	No 4	Maybe
• Cost of a hijack or Enron style fraud will be avoided. Cannot be captured in a non financial term. • Use of customer information for the banks will increase ability to understand clients and sell relevant products (not a direct consequence but enabled by FICA). • This information will be relied upon to protect the parties transacting in a more sophisticated banking environment.	• Will cost banks, customers and the economy more than it will provide. • The amount of protection does not exceed the sum of the direct and indirect costs. • Does not do much for South Africa except international compliance and legislation is more form than substance.	

5. Do the benefits of the legislation exceed the cost?		
Yes 6	No 4	Maybe
• It is vital to the reputation of the country that this legislation is in place.		

5.3 Financial Advisory and Intermediary Services Act (FAIS)

5.3.1 Phase 1

Table 6: FAIS - documentary research results

1. Purpose
The main purpose of the Financial Advisory and Intermediary Services Act (FAIS), enacted in November 2002, is to ensure that the rendering of intermediary services and/or giving of advice in relation to financial products is done in a competent and open manner. Through the FAIS processes, consumer protection is provided in terms of financial products and the integrity of the South African financial services industry is protected and enhanced . FAIS gives the consumer the right to be fully informed when buying a financial product or service and requires that competent and qualified persons render services and give advice. The broker should call the consumer's attention to all the important points in a financial product, including all the exclusions, limitations and the excess payments. To force competence, FAIS defines the qualities that an individual should exhibit in order to meet the quality and competency requirements of the role assumed in the subordinate legislation called Determination of Fit and Proper requirements for Financial Services Providers, 2003. This requires the following:- • Honesty and Integrity; • Competence (qualifications and experience); • Operational ability; and • Financial soundness. FAIS also requires that each financial service provider must ensure that a compliance function exists or is established as part of its risk management framework
2. Contribution to Enabling Environment
The major contribution to the enabling environment is related to the exploitation of the new consumers that will be created by the increased access provided in the industry. FAIS will ensure that these new and vulnerable consumers of financial services are not exploited.

3. Stakeholders

	Benefits	Costs
Banking Customers	• Ombudsman to deal with queries. • Provides clients with trusted and appropriate advice and solutions. • Providers act with integrity, transparency and a culture of discipline when dealing with clients. • Protection by means of appropriate and trusted advice, integrity and transparency. • Maintaining high standards. • An effective complaints resolution mechanism. • Protection through the continued existence of the FSP. • Proper monitoring of advisers', consultants' and actuaries' actions. • Record keeping of advice and communication. • Ensuring that advisers are competent.	• Onerous documentation.
Banks	• Reduction of ‘cowboy’ brokers that caused reputational damage to the banking industry.	• Onerous documentation. • Requirement to obtain a licence. • High cost of training.
Shareholders	• Better returns as a result of better quality advice	

	Benefits	Costs
Society in South Africa	• Protection of new consumers of financial services products from exploitation.	

Sources: Financial Advisor and Intermediary Services Act. (2002), Moleketi (2005), BANKSETA (2003)

5.3.2 Phase 2

Table 7: FAIS - interview results

1. Purpose
• Protection of the consumer from financial exploitation (4). • Ensures that consumers understand the benefits and cost of the products and how the advisor is being rewarded. • Stop the miss selling of financial products. • To ensure that the salesmen of financial products are competent and sell the correct products in all situations (2). • To provide better disclosure to the customer of the intangible products which have uncertain future values and are based on the reputation of the service provider (2).
2. Contribution to Enabling Environment
• Adds good governance at the level where service is conducted and enhances professional conduct of business. • Ensures better service and enables more effective allocation of resources. • Has a negative effect on access as the cost to take on clients will prevent the bank from providing services at the lower end of the market. • Ensures that intermediaries are behaving appropriately, customers are purchasing the correct products and people feel safe to use the system. • Develops trust between the consumer and the institution in terms of products and quality of advice. • Adds to sustainability by reducing the reputational risk inherent in the provision of these services.

3. Pillars of the Enabling Environment Supported				
Good Governance	Coordinated formal sector activity	Strong legal framework	Improving social conditions	Well developed financial system
9		5	4	8

4. Stakeholders			
	Interviewee	**Benefits**	**Costs**
Banking Customers	Commentator	• Reduces the number of small unqualified brokers thus improving advice to customers. • Protection of customers' sensitive financial information. • Structured, consistent process of financial advice. • Greater protection of consumer from financial mismanagement such as Masterbond.	• Increase in the charges that will be applied to customer.
	Bank Executive	• Forces financial service providers to provide proper advice and analysis. • Forces structure into advice process. • Appropriate provision of products by providers (2).	• Becoming a tick the box and sign exercise – documentation over true service provision. • Structured approach can not always be applied and may be ineffective. • Commissions may be higher.
Banks	Commentator	• Removal of the smaller, unqualified competitors decreases	

	Interviewee	Benefits	Costs
		competition from independent brokers. • Will have documented proof of authority to access information.	
	Bank Executive	• Avoid miss selling so bad deals are avoided and good deals done particularly in a stronger ombudsman environment. • Compliance enhances the reputation of institutions. • More competent staff will improve quality of sales and increase profitability. • Develops trust between the banks and the customers.	• Short term compliance costs (2). • Training and additional documentation cost (2).
Shareholders	Commentator		
	Bank Executive	• Improved profitability will improve returns for shareholders. • Sustainability of the entity due to improved trust.	• Costs will not all be recharged therefore some of the cost will be carried by the consumer.
Society in South Africa	Commentator	• Make the general population more secure in its interaction with financial system.	
	Bank Executive	• Expanded confidence in financial products.	

5. Do the benefits of the legislation exceed the cost?		
Yes 6	No	Maybe 1

• It will take away from both sides of the distribution improving the bottom and limiting the top. • The industry image will be substantially improved. • Should already have properly educated consultants (2).		• If the general public is saved from something like Masterbond, it may justify the cost and restriction of access. If not, this legislation may be imposed on institutions that were not abusing their position.

5.4 Basel II

5.4.1 Phase 1

Table 8: Basel II - documentary research results

1. Purpose
The Basel II requirements, contained in the final version of the Basel II accord issued in July 2004, are a revision of the capital adequacy framework that was established under the 1988 Basel Accord (Basel I). This accord expands on the guidelines that international banks must follow for risk management and the disclosure of risk calculations. The primary purpose of the implementation of the Basel framework is to promote the safety and soundness of the financial system to the benefit of the economy. It is a global standard and is being widely adopted internationally as, with the increasing extent of globalisation, financial system stability extends across national borders. Also further precipitating the requirement for the Basel framework is the increasingly complex financial engineering practiced by banks to fulfil the needs of their clients. This product development has resulted in the appearance of complex financial products that bring substantial risk into the financial system. The requirements encourage a more comprehensive approach to managing risk by making capital requirements more sensitive to risk and improving risk transparency and disclosure. The Basel II standards are detail in three pillars:- • Pillar 1: requirement to maintain minimum capital against credit risk, market risk and operational risk exposures. • Pillar 2: Sound capital management, including the holding of sufficient

capital to cover the risks to which the bank is exposed, must be demonstrated.

- Pillar 3: Meaningful disclosure must be made of information relating to available capital, capital management and risk exposures.

2. Contribution to Enabling Environment

- Banks perform an important function within a modern economy and a sound and efficient banking system is a necessary prerequisite to a healthy, growing economy. The primary goal of the South African regulators is to ensure that there is a minimum level of stability in this banking system. The Basel II regulations bolster this primary function by ensuring the safety and soundness of the individual banks, thereby enhancing the stability of the banking and broader financial system to ensure that the economy receives the benefits that can be offered by a stable financial system.
- Part of the conditions for an enabling environment is good governance. The Basel standards are international standards that have been developed by the Basel Committee of Banking Supervision of the Bank of International Settlement, located in Basel, Switzerland. They have been adopted by more than 100 of the economically advanced countries in the world. Adopting these standards in South Africa will allow the country to interact with the global economy according to international rules and give the enabling environment the legitimacy it requires for success.

3. Stakeholders

	Benefits	Costs
BankIng Customers	• Stable and efficient banking system.	
Banks	• Improved capital management and the reduction in cost of capital ensuring viability of marginal investment projects. • Improved quality of decision making by:- ↳ Active portfolio management of pricing and exposure limits across products and market segments. ↳ Risk based pricing using customer or market segment characteristics as the basis.	• Staffing of the required project teams with relevant experts in a competitive market (required by all banks). • Building of the data and systems infrastructure. • Redesign of the business processes to produce required results. • Collation and purification of the necessary data from multiple sources. • Compliance with multiple

	Benefits	Costs
	➢ Measuring profitability using the risk adjusted return on capital. • Increased process, operational and cost efficiencies from reduction in duplication, removing non-value added activities and data integration. • Enhanced reputation and improved ratings by rating agencies.	regulators. • Validating and maintaining the credit and operational risk approaches.
Shareholders	• Level of transparency and risk disclosure will be improved. • More accurate risk decisions should increase profitability and decrease risk. • Higher return on equity from advanced analysis and risk based pricing.	• Internal focus of the bank resources on compliance removing resources that could be applied to external initiatives.
Society in South Africa	• Standing and credibility of the country in the international arena will be improved. • Enhanced reputation and improved country rating by rating agencies.	• Internal focus of the banking sector resources on compliance removing resources that could be applied to external funding / growth initiatives.

Sources: Alexander, Dev, Kopp and Russo (2005), Kruger (2005), Zattler, Hansen and Pullen (2003), Bernanke, (2006), Ernst & Young (2006)

5.4.2 Phase 2

Table 9: Basel II - interview results

1. Purpose
• Create long term stability in global banking systems (3). • Capital held to cover the risk is better aligned to the real risk (3). • An appropriate system for capital allocation / adequacy in the banking system (3). • Strengthen the mechanisms of central bank control with a consistent international standard of regulation. • Reduction of regulatory burden though the emphasis on market conduct. • To ensure that the regulation of banks remains aligned with the

management.

- Create better risk management environment in which both credit and operational risk is more thoroughly evaluated.

2. Contribution to Enabling Environment
• Provides comprehensive and consistent regulation and provides guidance as to good governance. • Will result in better allocation of capital and therefore resources. • Provides guidance on what good governance should be. • If implemented properly, will reduce cost that will benefit shareholders and could be passed on to the consumer (2). • Compliance is necessary to remain within the global banking system. • Better capitalised banks with better risk management frameworks are good for economic activity.

3. Pillars of the Enabling Environment Supported				
Good Governance	Coordinated formal sector activity	Strong legal framework	Improving social conditions	Well developed financial system
6	1	8	2	8

4. Stakeholders

	Interviewee	Benefits	Costs
BankIng Customers	Commentator	• Can expect well managed and well matched assets and liabilities.	• Costs passed to customers through higher charges. • Pricing could result in higher charges due to the customer's status.
BankIng Customers	Bank Executive	• Products are appropriately priced for risk (2). • Ensures that the customers can rely on a well capitalised, well regulated custodian of their funds. • Consumers with better conduct will be rewarded as cross-subsidisation is removed.	• Risk premiums for certain classes of customers may be increased preventing further use of products. • Costs passed to customers. • May penalise the lower end consumer and remove the access that the regulation is trying to improve.

	Interviewee	Benefits	Costs
Banks	Commentator		• High consulting costs iro IT systems, audit and legal aspects. • High IT systems costs. • Costs are not once off but will be ongoing.
	Bank Executive	• Provides consistency amongst the international banks. • Forces banks to more accurately consider and measure risks leading to better business understanding. • Fewer losses through better risk management. • Capital savings through better capital management and no waste of capital. • Alignment between management and regulators. • Depends on effective use of provisions to reduce capital.	• Complexity of regulation makes it difficult to comply. • System and data administration costs (2). • People skills and training (2). • Large flow though can be expected from the processes that will need to change when Basel is implemented. • Business model changes will be needed to facilitate the requirements.
Shareholders	Commentator		
	Bank Executive	• Bank is managed in economic and not financial terms. • Increases value based management with improved risk adjusted returns.	• Costs passed onto the shareholders.
, in South A	Commentator	• Compliance will ensure that external investors do not exclude South Africa as a financial	• May drive banks away from servicing the lower end of the market. • Costs are unfairly

	Interviewee	Benefits	Costs
		market.	focused on the banking sector.
	Bank Executive	• More integrated and stable financial system (3). • Country specific exclusions provide scope for South Africa specific benefits. • Better capitalised banks with better risk management frameworks are good for economic activity. • Levels the international playing field with respect to competition.	

5. Do the benefits of the legislation exceed the cost?		
Yes 7	No 2	Maybe
• Forces banks to more accurately consider and measure risks leading to better business understanding. • Will ensure that South African banks continue to raise funds and have international correspondent banking relationships, finance trade etc to keep South Africa Inc running. • If properly managed the saving in capital could be huge benefiting the banks, consumers and indirectly the general population. • Long term as it will definitely be beneficial once the costs of	• Amount of money spent to implement BII will never be covered by the benefits that can be achieved. • Heavily engineered solution inapplicable to South African market that has large social demands.	

5. Do the benefits of the legislation exceed the cost?		
Yes 7	No 2	Maybe
implementation have cleared through the system. • Gives a message to the international community that our banks are stable and well managed and understand their risk.		

5.5 Financial Services Charter (FSC)

5.5.1 Phase 1

Table 10: Financial Services Charter - documentary research results

1. Purpose
Despite significant progress since the establishment of a democratic government in 1994, South African society remains characterised by racially based income and social services inequalities. This is not only unjust, but inhibits the country's ability to achieve its full economic potential. Black Economic Empowerment is a mechanism aimed at addressing inequalities and mobilising the energy of all South Africans. It will contribute towards sustained economic growth, development and social transformation in South Africa. Inequalities also manifest themselves in the country's financial sector. A positive and proactive response from the sector through the implementation of BEE will further unlock the sector's potential, promote its global competitiveness, and enhance its world class status. Equally, the financial stability and soundness of the financial sector and its capacity to facilitate domestic and international commerce is central to the successful implementation of BEE. The Financial Sector Charter, effective 1 January 2004, is a transformation charter defined in terms of the Broad-based Black Economic Empowerment [BBBEE] Act [Act 53 of 2003]. The charter was voluntarily developed by the sector and constitutes the principles and framework upon which BEE will be implemented in the financial sector. The charter provides a basis for the sector's engagement with other stakeholders, establishes targets and responsibilities in respect of each institution and outlines implementation processes and mechanisms to monitor and report on progress. In pursuit of these objectives, the Charter commits financial institutions in the sector to transforming in the areas of: • Human resource development;

- Procurement of goods and services;
- Access to financial services;
- Empowerment financing [including targeted investments in transformational infrastructure, low-income housing, agricultural development and black SMEs as well as BEE transaction financing];
- Ownership and control; and
- Corporate social investment.

2. Contribution to Enabling Environment
The Charter commits its participants to 'actively promoting a transformed, vibrant, and globally competitive financial sector that reflects the demographics of South Africa, and contributes to the establishment of an equitable society by effectively providing accessible financial services to black people and by directing investment into targeted sectors of the economy' (Financial Services Charter, 2004, p1). By addressing the challenges of: black participation in and access to financial services; the provision of loans to black entrepreneurs; effective generation and mobilisation of savings and investment to development projects of national importance; and the formalisation of the large informal savings pool, the financial sector will make a significant contribution towards economic growth, development, empowerment and reduction of inequalities and poverty in our society.

3. Stakeholders		
	Benefits	**Costs**

	Benefits	Costs
Banking Customers	• More credit to black entrepreneurs incentivised by empowerment credit guidelines. • Increased access to financial services through low cost product offerings such as Mzanzi. • Increased ability to save and invest leading to individual financial security.	
Banks	• Negotiated and considered targets set by banking industry not imposed by government.	• Skills development. • Reduction of procurement flexibility potentially resulting in higher cost. • Enforced development and provision of unprofitable banking products.
Shareholders		
Society in South Africa	• Greater part of the savings pool under the control of the banking sector into targeted investments of national priority. • Formalisation of a large pool of funds outside the formal financial system, in stokvels, informal traders etc.	• Inefficiency in the banking system.

Sources: Financial Services Charter (2004), Scott, Tucker and Monschean (2005), Garach (2006), Moleketi (2005)

5.5.2 Phase 2

Table 11: Financial Services Charter - interview results

1. Purpose
Correction of historical, politically motivated imbalances in the economy (2). Extension of the financial system to those who were previously excluded from access to banking products and credit / finance.
Create black empowerment, increase access to financial services and encourage enterprise development (2).
Procuring private sector involvement in achieving the government's political and social agenda.
Uses enlightened self interest and competitive forces to drive behaviour towards the necessary change. It is essential to remove the dominance of an entrenched minority racial group on the economy that would not disappear as a result of normal competitive and market forces.
To contribute to the transformation of the society and the economy of South Africa and give access to assets, income and financial opportunity on a more equitable basis.
2. Contribution to Enabling Environment
Lower barriers to entry into the formal sector e.g. Mzanzi and SME lending.
Recruiting policies will improve the employability of disadvantaged people.
Focusing the banks on areas where stimulation of the market is necessary such as low income housing.
Created a mindset where the un-banked feel that they can safely go to a bank and use the services. Has not achieved its purpose in the low cost housing area. It has turbocharged skills development.
Not really contributing as it protects the inefficient and sanctions discrimination which is what the country has been trying to move away from. Philosophy is valid but the time frames are not conducive to success. Such changes take more time.
Is providing a critical mass of black shareholders with vested interests in the economy driving them to work towards protecting as opposed to destroying the economy.
The targets that have been set per the charter will increase the number of people that will benefit from the economy and make the financial system more inclusive.
Builds up the reputation of the banking industry as an important element in the economy.
The contribution depends on the adoption of the charter by the banks. If it is adopted as a necessary evil and a minimalist approach is used in its implementation, the contribution will be less valuable. It cannot be approached with a compliance view and must be seen as a business imperative.

3. Pillars of the Enabling Environment Supported				
Good Governance	Coordinated formal sector activity	Strong legal framework	Improving social conditions	Well developed financial system
2	8	1	7	3

4. Stakeholders			
	Interviewee	**Benefits**	**Costs**
Banking Customers	Commentator	• Benefit to have taken some of the bitterness out of the process. • Has stimulated innovation in the provision of banking services e.g. Bank in a Box etc. • In response to charter provisions, easier assess to financial services has been provided by banks.	
	Bank Executive	• Has provided access to products that would not have been provided if the focus had not been created by the charter provisions (2).	• Industry initiatives are not as efficient as competitive initiatives. Mzanzi accounts are not profitable so banks are not pushing the product and uptake is low. • Mzanzi product does not meet the needs of the customer. • Costs of the initiatives that are not profitable are passed on to the consumer.
Banks	Commentator	• Banks are more accessible and easier to deal with. • Positive scoring on the Charter codes will attract the corporate business as their scorecard is linked to the Charter status of	• Training and up-skilling of personnel (2). • Negative implications are chasing away 'white' skills reducing talent that may be available (2). • Distraction of putting

	Interviewee	Benefits	Costs
		their banks. • Has contributed to the growth of the banks' market presence.	energy into non profitable business lines e.g. low income housing.
	Bank Executive	• Long term expansion of the market through more creative thinking, different segments and new customer bases that would not have otherwise been addressed. • Different perspectives provided by the new employee groupings. • By the focus on various segments which were not previously considered, profitable business is being generated (2).	• Costs depend on the approach taken – compliance vs business opportunity (2). • Management time (2). • Training costs • Additional supplier costs due to lack of scale of BEE suppliers • Artificial segregation of supplier's (scarce BEE suppliers vs all others) changes cost dynamics i.e. may pay more for lesser quality. • Costs to establish new distribution channels. • Failure on the scorecard will result in a loss of business from parastatals and compliant corporates. • Opportunity cost of the resources applied to charter related business that could have been applied in other areas.
Shareholders	Commentator		• Once off cost of dilution of shareholder value. • Suppressed prices of BEE companies.
	Bank Executive	• Long term growth of the industry will ensure that banks remain a good investment. • Ensures banks remain relevant to society and are not marginalised.	• Cost of Black Economic Empowerment deals.

	Interviewee	Benefits	Costs
Society in South Africa	Commentator	• Increased focus on skills development.	• Tokenism and window-dressing is taking place due to unrealistic timeframes undermining true skills development and affecting performance of operating units.
	Bank Executive	• Broaden the size of the market and economy. • Contributes to the long term sustainability of the economy and the country as a whole (2). • Makes the commercial system politically credible. • Improves access to banking products. • Through stimulating the development of transformational infrastructure, more people's lives will be normalised. • Through focused lending and procurement to previously disadvantaged companies the development of new businesses is stimulated.	• Must avoid tokenism and window-dressing. • Behaviour linked to short term target setting may result in limited benefit.

5. Do the benefits of the legislation exceed the cost?		
Yes 7	No 3	Maybe
• Theoretical benefits will exceed the costs. Benefits are difficult to measure but not doing it is not an option. • Will benefit longer term as short term costs will provide long	• When looking at Mzanzi, the costs of the product and losses that the banks are incurring are exceeding the benefits of creating new banking	

5. Do the benefits of the legislation exceed the cost?		
Yes 7	No 3	Maybe
term benefits through more accessible banking and economic effect of wealth created by the BEE deals. • Benefits of the self imposed regulation are far better than some government imposed regulation (2). • If the banks approach the FSC as a business opportunity not a compliance initiative, the benefits will definitely exceed the cost. • Will improve access and have a large, positive impact on the employment equity.	customers. • Skills development is not occurring as intended and discrimination is actually being counterproductive. • This is not yet properly conceived. It is the first attempt and the targets are not well set with some soft and other impossible targets set. The banks will fall short of the targets and the goalposts will have to be moved to get the benefits required.	

5.6 Overall indication of contribution to enabling environment

Table 12: Overall contribution of regulation

Overall perception: Is regulation working towards an enabling environment?	
Yes 8.5	No 1.5
• Currently effects of not having these regulations can be seen. Any country should have conduct of business guidelines and these regulations provide these guidelines. • Legislated environment has brought South Africa on par with international best practice to foster international investment. But is going too far as is 1st world legislation in 3rd world. Same conditions applied to undeveloped population as to developed e.g. FICA. • It is more focused on the modernisation of existing legislation and ensuring that the South Africa has the best possible credit rating through a sound regulatory framework backed by a sound banking system. • Has a strong focus on access balanced by good governance but cost is detrimental to banks. • World is in the phase of consumer protection and our legislation working towards the protection of the consumers and improving their social conditions. • Making the SA banking system comparable to the best in the world in governance, risk management, distribution of economic power and capital management. Are swinging to the extreme of regulation and should be careful that this does not change the outcome but in	• Good for the upper and middle markets but are having adverse impacts at the lower end. There are too many unintended consequences that are not working towards the enabling environment particularly in barriers to entry where it has been net negative. • International regulation is raising barriers to entry. The necessary South African compliance has the unfortunate consequence of restricting access and working against the enabling environment.

Overall perception: Is regulation working towards an enabling environment?	
Yes 8.5	No 1.5
general, benefits will exceed the costs. • The intention is definitely to work towards the enabling environment. There is a need for a strongly regulated banking environment to create a strong financial system because without such legislation a favourable investment environment will not be created. There are, however, differences between intention and implementation. The amount of legislation being applied to the banks is substantial and there is a question as to whether it can be properly implemented. The banks are being subjected to large amounts of legislation all at the same time often released in an uncoordinated manner.	

6 Discussion of results

This chapter contains a discussion of the major findings of the study. It ties together the information from the documentary research and the opinions of the respondents with the relevant detail from the literature review.

Since the intention is to answer the research questions posed in chapter 3, the logical structure of this section should be to discuss the findings of the research in the context of each of the questions. However, in this study, 5 legislative elements were reviewed and the questions considered for each of the elements. If the discussion is aligned by question, the flow of the results for each element is lost and the presentation of the results disjointed. As a result, to ensure a logical flow, this chapter has been structured by legislative element for the first three questions. These questions are:-

- What is the purpose of each of the legislative elements and how may each element make a specific contribution to the enabling economic environment?
- What are the specific benefits and the components of cost of each of the legislative elements and which stakeholder groupings will receive the benefit and incur the costs?
- Will the overall benefits accrued from each legislative element exceed the costs incurred?

These three research questions will be repeated as sub headings under each element.

The final research question is:-

- Is regulation in South Africa banking aligned towards creating an enabling economic environment stimulating economic growth?

This question relates to the overall South African regulatory environment and as such will be discussed in the final section of this chapter.

The results tables in chapter 5 are broken up into a number of sections. These sections have been sequentially numbered to facilitate references to the results they contain. When reference is made to these tables in the analysis, the number in brackets refers to the table section in which the information can be found e.g. Table 2 (3) refers to section 3 of table 2.

6.1 National Credit Act (NCA)

6.1.1 Purpose and contribution to enabling environment

What is the purpose of the National Credit Act?

The purpose of the NCA is the protection of the consumer by a regulatory focus on the provision of credit. As detailed of table 2 (1), the Act aims to create a fair and non-discriminatory lending marketplace that redresses power imbalances between lenders and borrowers, ends exploitative practices and creates consumer protection structures.

As detailed in table 3 (1), the respondents' comments corroborate this definition. They believe that the NCA creates a standard, consistent, credit provision framework that increases access to credit, ensures responsible and affordable lending and ends the exploitation of the financially illiterate by preventing misguided consumerism and removing discriminatory credit qualification requirements

The discussion of the South African government's development objectives in 2.5 above mentions the existence of a dual economy that developed as a result of the Apartheid policies (RDP, 2004). The post 1994 economic policies have attempted to address this segregation and reintegrate these economies. According to one of the respondents (Table 3 (1)), the NCA is a part of this reintegration with the purpose of merging the formal and informal credit markets to normalise and regulate the informal market and encourage the established banks to move into less traditional markets creating healthy competition and driving cost down.

How may the National Credit Act make a specific contribution to the enabling economic environment?

Table 2 (2) shows that the documented views suggest three main areas of contribution:-

- Access to credit through a more efficient, affordable credit market;
- The stimulation of small business by the extension of credit; and
- The creation of competition.

Summarised together these factors are exactly the type of financial provision that gives the banks a key role in the economy (Hawkins, 2003)

The views of the respondents in table 3 (2) show more of a focus on the protection of the consumers, especially the weaker consumers, from exploitation in order that they are more economically active and can contribute to the economy. Also noted was the redressing of the poor business practices to create a 'level playing field' that will allow consumers to enter the formal banking system and build assets. Such redressing of the injustices of the past continues towards achieving the government's development objectives, detailed in section 2.5, defined first by RDP (1994) and subsequently by the GEAR (2006).

Although most of the respondents' views of the NCA's contribution were positive, there was some concern that the basis of the legislation, being from developed countries, was too puristic and promulgated after a poor consultative process. The international basis has resulted in an over-engineered solution that has gone too far and applied micro-loan focused legislation across the whole credit sector. This view, however, is fairly isolated as the majority of the respondents endorsed the NCA as positively contributing and felt that it is good legislation introduced through an effective consultative process.

Section 2.4 above defines an enabling economic environment. Calamitsis (1999), Kirkpatrick and Piesse (2001) and Bannock *et al* (2003) between them define five pillars that support an enabling economic environment.

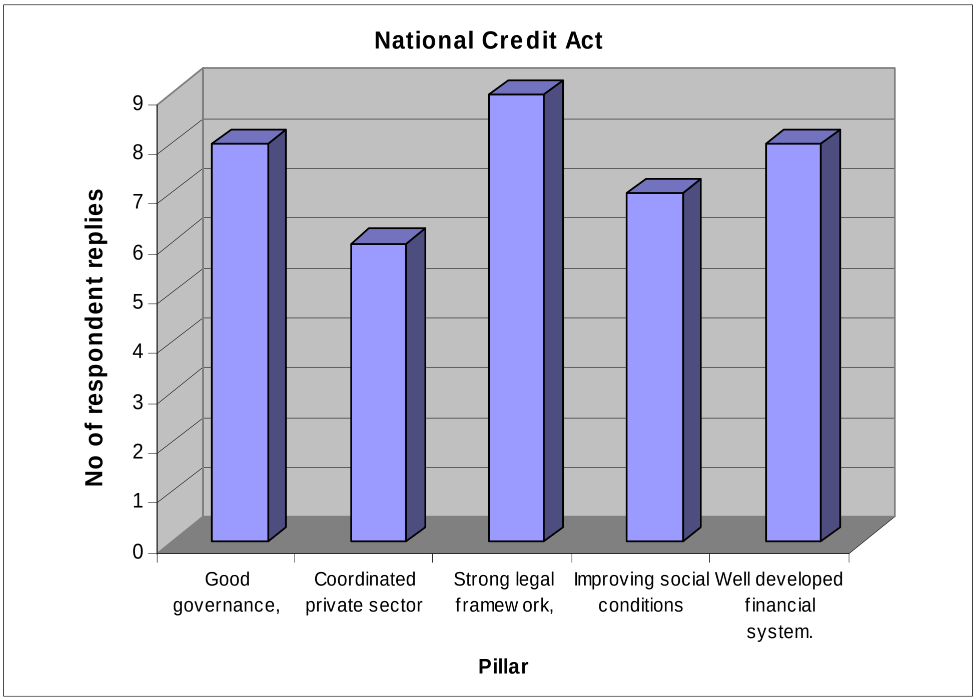
These pillars are:-

- Good governance,
- A coordinated private sector with low barriers to entry,
- A strong legal framework,

- Improving social conditions; and
- A well developed financial system.

Despite the reservations, if the contributions are viewed in context of these pillars, the NCA substantially supports this enabling environment. The opinions of the respondents, detailed in table 3 (3) and displayed in figure 4, show that there is a balance of opinion across all the pillars of the enabling environment with the strongest contribution being in improving social conditions, strengthening the legal framework and ensuring a well developed financial system.

Figure 4: Contribution of the NCA to the enabling environment



6.1.2 Benefits and costs

What are the specific benefits and the components of cost of the NCA and which stakeholder groupings will receive the benefits and incur the costs?

As stated in 6.1.1 above, the focus of the NCA is consumer protection. It would be expected therefore that the major benefits will accrue to the banking customers. A review of the benefits detailed in table 2 (3) and table 3 (4) confirms this expectation. Benefits to the banking customers can be summarised into three areas, protection, competition and access. Customer protection is enabled by a managed debt experience, a high focus on consumer education, the exclusion of non-compliant lenders and industry regulation structures to enforce the provisions. Competition is created through the normalisation of the industry and the focus on affordable lending, resulting in lower prices for bank customers. Finally, this normalisation and focus, especially of the larger banks on areas that they may not have previously addressed, will increase access for the consumer.

The benefits, however, do not only accrue to the consumer. There are benefits to the banks, the extent of which will be determined by the attitude of the banks in their approach to the legislation. The respondents indicate that if the banks embrace the legislation by, for example, refocusing on customer centricity and look at innovative ways to use the resulting information, benefits will accrue through a better customer relationship and lower bad debts.

These benefits to the bank flow through to the shareholders. The effective compliance with legislation and better credit processes result in an investment in a leading edge company that is a good corporate citizen with a greater potential customer base. Also, the long term contribution of the bank to improving social conditions by responsible credit extension will ensure the ongoing prosperity of the industry.

Finally, of great importance to the enabling environment is what Bannock *et al* (2003) describe as the facilitation of the private sector in a co-ordinated and efficient manner to stimulation growth and the protection of this investment through a strong legal framework. The NCA will provide a more stable lending environment facilitating greater developmental borrowing that will contribute to asset formation in the country, benefiting South African society.

The implementation of this legislation does not come without a large cost element. A review of the responses regarding costs, detailed in table 2 (3) and table 3 (4), shows that both once-off and ongoing costs will be incurred by the banks due to the implementation of the NCA. High once-off costs will be incurred to change credit and product policies, realign the systems and processes, train all staff and educate the customer base. The responses also show that the NCA affects the ongoing cost of the entire lending cycle. The origination costs will be increased due to the requirement for affordability assessments, the end to end processing of the loans will become more onerous due to the higher administrative burden, and the slower collections due to the longer counselling process will result in a cost of funding the loan whilst counselling is in progress. There is a concern that these costs will have the unintended consequence of driving banks away from the lower end of the market.

For banking customers, the cost of the NCA may be that the complex and onerous application process excludes certain people from the credit market, particularly in the short term and the high origination and collection costs make the lower end of the market expensive and unattractive. These costs are contrary to the intention of the enabling environment (Bannock *et* al, 2003) and more specifically the purpose of the NCA. An observation in table 3 (4) even went as far as suggesting that the credit exclusions will stimulate the activities of the illegal lenders, completely opposite to the regulation that the NCA provisions are trying to achieve.

These concerns extend to the costs to society. The activities of the 'extra legal' lenders erodes the value of the money held by the lower end consumers, impinging on normal economic activity, ensuring that poverty is not addressed and reversing the trend of access that the legislation is trying to achieve.

6.1.3 Cost – benefit of the regulation

Will the overall benefits accrued from the National Credit Act exceed the costs incurred?

As can be seen in table 3 (5), the consensus of the respondents was not definitive on the cost-benefit of the NCA.

The positive respondents indicated that a well managed consultation process had resulted in a good balance between the concerns of the industry and the government objectives. They concluded that if the positive provisions are proactively used by the banks and innovatively exploited, real benefits can be achieved. The negative respondents were concerned that the positive provisions would be difficult to leverage, the solution was over-engineered and the costs of compliance would reduce rather than promote access. The neutral response indicated that for benefits to exceed costs, some conditions such as high growth and a stronger culture of discipline, integrity and responsibility would need to be met.

Overall, despite the negative and neutral views, the responses indicate a consensus that in the long term the benefits of the NCA should outweigh the costs. In order to ensure that this regulation is efficient and effective, characteristics defined by Falkena *et al* (2001) as important for the success of regulation, a positive and innovative response is required from the banks and there needs to be an improvement of certain social conditions.

6.2 Financial Intelligence Center Act (FICA)

6.2.1 Purpose and contribution to enabling environment

What is the purpose of FICA?

The Financial Intelligence Centre Act is legislation that is aimed at the prevention of money laundering and the deterrence of organised crime, terrorism and drug dealing. As detailed in table 4(3), it is part of the international activity of Anti-Money Laundering. Tshabalala (2005) details compliance to international banking standards as one of the government's focus areas. FICA is part of the government initiative towards compliance with these international standards, ensuring that the reputation of the financial services industry is maintained.

The responses obtained from the interviews detailed in table 5 (1) varied from 'an important element of the protection of the country's economy' to 'legislation with absolutely no purpose'. The majority, however, indicated FICA attempted to address the prevention of crime and terrorism and was necessary to counter illegal activity that may be detrimental to South Africa's image.

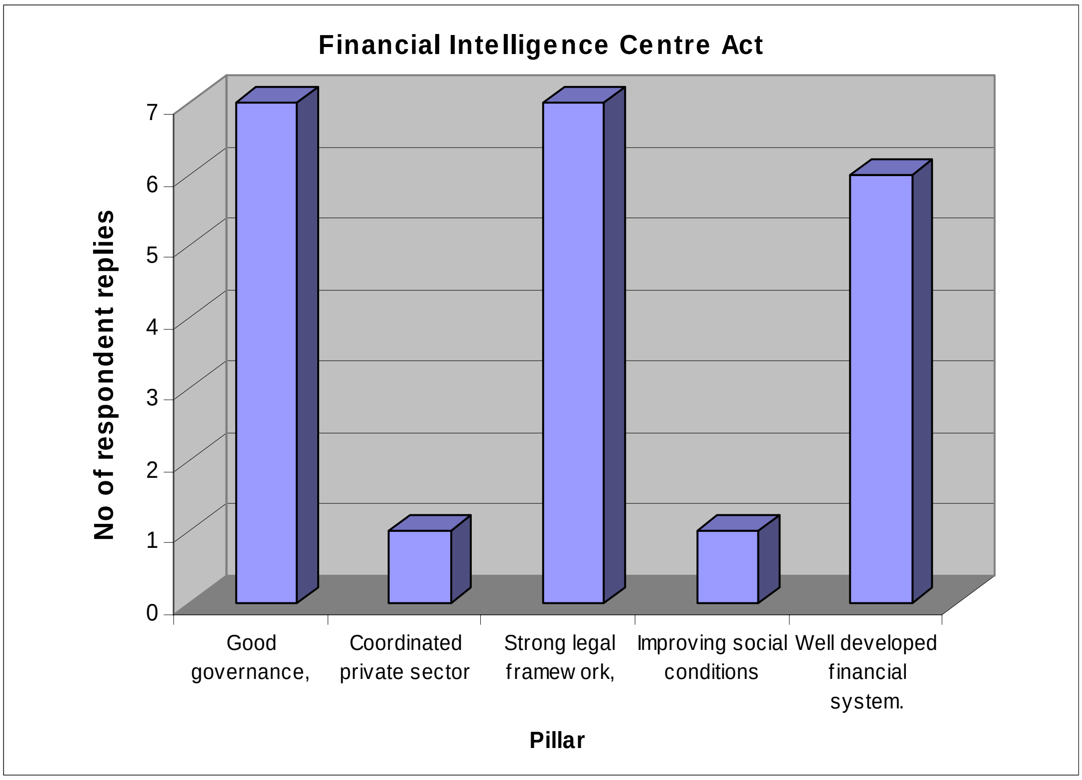
How may the FICA make a specific contribution to the enabling economic environment?

The interview responses detailed in table 5 (3) indicate both positive and negative contributions to the enabling environment. Two themes dominate the positive responses, crime reduction and international legitimacy. The reduction of crime and the resulting lower cost to the economy translates into more resources that may be applied to the development of the enabling environment. In respect of compliance with international standards, Hawkins (2003) asserts that it enhances the reputation of the country and creates the good governance necessary in an enabling environment. The positive respondents agree and see this legislation as a reputational necessity that will improve the investment potential of the country.

The negative responses centre on the extent of the legislation. They assert that the requirements of the act have created a barrier to entry for consumers and that the volumes of information created by the bureaucratic system can never be effectively investigated or policed. There is a strong indication that South Africa, which is one of the only countries where FICA requires the confirmation of all existing customers, has taken this legislation too far and in doing so has rendered it inefficient, contrary to the requirement, discussed by Falkena *et al* (2001) that regulation should not impair the efficiency of the financial markets .

In terms of the pillars of the enabling environment defined by Calamitsis (1999), Kirkpatrick and Piesse (2001) and Bannock *et al* (2003), as can be seen in figure 5, the respondents identify good governance, a strong legal framework and the contribution to a well developed financial system as supported by the FICA legislation.

Figure 5: Contribution of FICA to the enabling environment



6.2.2 Benefits and costs

What are the specific benefits and the components of cost of the FICA and which stakeholder groupings will receive the benefits and incur the costs?

The majority of the benefits, detailed in table 4 (3) and table 5 (4), flow from the positive themes identified in 6.2.1. and accrue to the banks and society. Crime reduction and the associated cost savings as well as the intangible benefits of customer confidence and integrity, the creation of a more honest society and increased social discipline are all listed as benefits. Benefits, relating to the compliance with these international standards, include the reduction of reputational risk for the banks, an overall improvement in the financial health of the country and the extension of a good judicial system which, combined with the other factors, enhances the international image of the country.

An interesting observation that can be made from the information in table 5 (4) is that the respondents see no benefits for the banking customers provided by the FICA legislation. Also surprising is the strength of the benefits for the banks indicated by the bank executives. They add benefits such as the better understanding of the customer lifecycle and the use of the information obtained through the FICA process for direct marketing and cross-selling opportunities to the reputational protection and crime prevention benefits. This shows a substantially positive approach to the regulation.

The components of cost are largely incurred by the banks. These costs are both financial and non-financial. Financially, there has been a high cost to change the systems and processes to incorporate the verification procedures in the origination process, train the branch staff and to complete the once-off verification of all existing customers. Non-financial costs to the banks, highlighted by the respondents include the stifling of creativity and innovation and the damage caused to client relationships. The relationship damage has been caused, not by the conditions of the regulation, but by the manner in which the banks have executed the verification. The banks have difficulty in obtaining one view of the customer so have applied the verification procedures multiple times for the same individual or company. This has resulted in customer dissatisfaction and negatively impacted the reputation of efficiency in the banks.

A cost identified that applies to both the banking customers and the society is the restrictions that this legislation places on access to financial services. In a country where the majority of the population is rural, unemployment is a major issue (Gouws, 2006) and 57% of individuals live below the poverty line (Schwabe, 2004), a large number of the population do not have the relevant documentation to fulfil the verification requirements of FICA. According to the respondents, this places a restriction on the use of financial services and prevents consumer access.

6.2.3 Cost – benefit of the regulation

Will the overall benefits accrued from the FICA exceed the costs incurred?

Table 5 (5) shows that 70% of the respondents agree that the benefits of FICA will outweigh the costs. However, the justification is based on the intangible benefits of reputation, knowledge of customers, and the protection of transactions on a more sophisticated banking platform. Those that take the contrary view do not feel that these intangible benefits can ever exceed the quantifiable direct and indirect costs of the legislation. Therefore, although numerically these results show the benefits will exceed the costs, a review of the detail could arguably show the opposite.

6.3 Financial Advisory and Intermediary Services Act (FAIS)

6.3.1 Purpose and contribution to enabling environment

What is the purpose of FAIS?

Like the NCA, the Financial Advisory and Intermediary Services Act has as its focus the protection of the consumer from financial exploitation. According to Bond (2005), the banking system plays a vital role in assisting individuals to achieve their financial goals. Financial exploitation works contrary to such a role. One of the respondents (table 7 (1)) defined financial products as intangible products that have an uncertain future value which is based on the reputation of the service provider. The consumer is purchasing these products based on the advice of a financial intermediary who is remunerated for making the sale but is not impacted by the consequence of poor performance of the product. This situation opens the possibility of the miss selling of financial products and the exploitation of uninformed consumers. The legislation has been promulgated to create a framework around the sale of financial services that protects the consumer, enhances the integrity of the South African financial services industry and gives the consumer the right to be fully informed and rely on competent and qualified persons to render service and give advice.

How may the FAIS make a specific contribution to the enabling economic environment?

According to the respondents (table 7 (2)), the provisions of FAIS provide good governance at the point where service is conducted, ensuring intermediaries are behaving appropriately and that customers are being sold products that are relevant to their financial needs. This protection, part of the good governance required by Calamitsis (1999) and Kirkpatrick and Piesse (2001) as essential to the enabling environment, adds to the environment by developing a trust between the consumer and the institutions, ensuring the sustainability of the industry, and creating a safe environment in which banking customers may purchase financial products.

Figure 6: Contribution of FAIS to the enabling environment

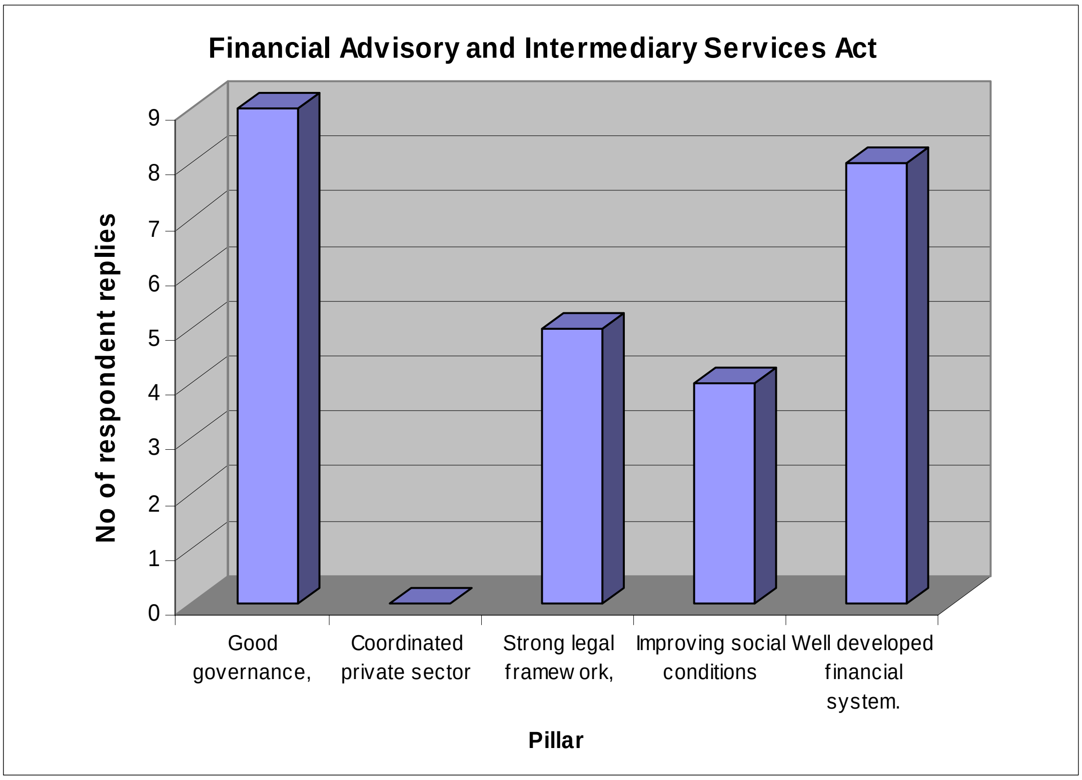


Figure 6 shows that the respondents see the pillars of good governance and the well developed financial system as supported by FAIS and that there is little or no support for the pillars related to the growth of the private sector and improving social conditions. One of the respondents went as far as defining a negative impact on the enabling environment related to access to financial services. The assertion was that the costs related to fulfilling the FAIS provisions for the lower end consumers will prevent the institutions from providing services to this segment of the market.

6.3.2 Benefits and costs

What are the specific benefits and the components of cost of FAIS and which stakeholder groupings will receive the benefits and incur the costs?

Table 6 (3) and table 7 (4) show the benefits and costs of the FAIS legislation. A review of these results shows that the benefits to the banking customers are largely derived from the protective structures put in place by the act. At the service level, the provisions of the act force structure into the advice process, protecting the customers' financial information and ensuring the provision of appropriate products. At the industry level, bodies such as the office of the financial services Ombudsman, monitor financial advisors actions and provide an effective complaints mechanism, protecting the interests of the customers.

Banks and shareholders benefit from FAIS through a better relationship with the customer, an enhanced reputation, a reduction in competitors as unqualified competitors are removed due to non-compliance and an increase in profitability resulting from a better quality of sales. There are lesser benefits for South

African society when compared to the other stakeholder groups. The only real benefit identified for society was increased confidence in the financial services industry.

The costs of FAIS for banking customers relate to the implementation of a structured approach. The approach can result in a compliance-only exercise where the completion of the structured documentation becomes the objective and not the provision of financial advice. This would result in the approach becoming ineffective. For the banks, the costs centre on short term compliance such as the cost to train the financial intermediaries and redesign the documentation and sales process. There were no costs identified for the society of South Africa.

6.3.3 Cost – benefit of the regulation

Will the overall benefits accrued from the FAIS exceed the costs incurred?

The consensus of the respondents, shown in table 7 (4), is that the benefits of this regulation will exceed the cost. The provisions of FAIS are viewed by some respondents as a part of good business practice that should already be included in the services rendered by financial institutions. It does, however, to some extent limit access to financial services. Compliance with FAIS will improve the image of the industry and improve business practices but the extent to which this improvement will result in quantifiable benefits to offset the cost of limited access will depend on its effectiveness in preventing the financial exploitation. On balance, the respondents believe that the benefits will exceed the costs.

6.4 Basel II

6.4.1 Purpose and contribution to enabling environment

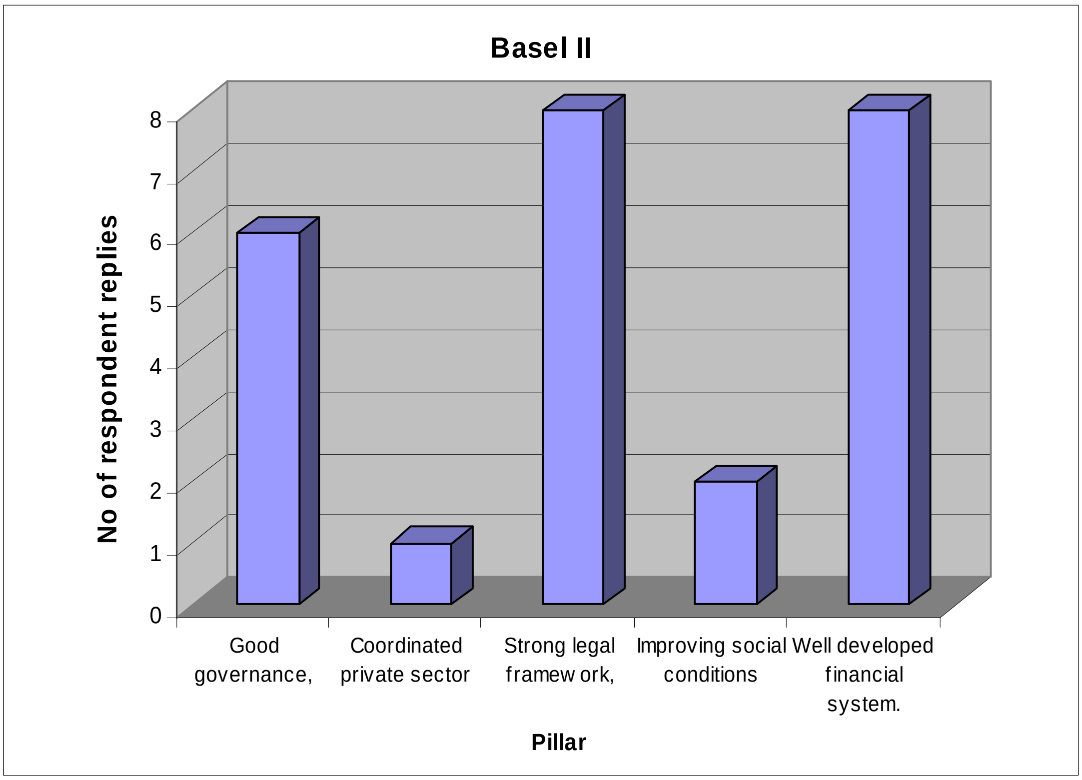
What is the purpose of Basel II?

The documentary research results in table 8 (1) define the primary purpose of the Basel II framework as the adoption of a global standard to promote the safety and soundness of the financial system. As mentioned in section 2.6, this stability is important if the financial system is to achieve the vital development role proposed by Bond (2005). The purpose of Basel II is to contribute towards the necessary stability. This view is corroborated by the interview results in table 9 (1) where the respondents stress the purpose of Basel II as the creation of long term sustainability in global banking systems by the implementation of an international standard of regulation. This purpose must be achieved by the introduction of a more comprehensive approach to risk management by making capital requirements more sensitive to risk. The Basel II approach strengthens the mechanisms of central bank control, reduces the regulatory burden by emphasising market conduct and better aligns the management of banks with the regulation.

How may the Basel II make a specific contribution to the enabling economic environment?

Wiese (1994) defined four major banking functions, detailed in 2.6 above, which together form an indispensable component of the financial system in an enabling environment. The stability and safety of this system are a necessary prerequisite for a healthy, growing economy. The primary contribution of Basel II is ensure that there is a minimum level of stability in this system (table 8 (2)) by ensuring the safety and soundness of the individual banks. Table 8 (2) also indicates the contribution of Basel II to the standards of good governance required by Calamitsis (1999) and Kirkpatrick and Piesse (2001) for an effective enabling environment. Adopted by more than 100 countries, Basel II has become the standard for good governance in the global economy.

Figure 7: Contribution of Basel II to the enabling environment



These contributions are echoed by the interview responses included in figure 7. The strong legal framework, required by Bannock *et al* (2003) in the definition of an enabling environment to ensure legal rights are safeguarded and contracts are enforceable, the well developed financial system required to ensure the stability of the financial sector and the good governance required by the banking community are strongly indicated in the interview responses as the major contributions of Basel II to the enabling environment.

6.4.2 Benefits and costs

What are the specific benefits and the components of cost of Basel II and which stakeholder groupings will receive the benefits and incur the costs?

According to the research results, the major benefits related to Basel II will be received by the banks and the South African society. The documentary research results in table 8 (2) show that if the Basel II provisions are implemented successfully, banks can take advantage of the provisions to reduce capital, increase the quality of decision making and improve their reputation. The bank executives (table 8 (4)) add more accurate consideration and measurement of risk, lower losses due to better management and alignment with regulators as additional benefits to the banks. The benefits attributed to South African society reflect the intention of Basel II as discussed in section 6.4.1. The respondents indicated financial system stability, better capitalised financial institutions and international alignment as major benefits.

The costs of the implementation of Basel II are substantial and will largely be incurred by the banks. As detailed in table 9 (4), the complexity of the regulation makes it difficult and onerous to comply. The respondents indicated that the costs would be incurred in the modifications required to systems, processes and people within the organisation. To perform the complex calculations required for the risk / capital evaluation, the systems within the banks need substantial re-adjustment. The risk management and other integrated business processes will require re-engineering to comply with the requirements and take advantage of the opportunities provided. The re-skilling and re-training of staff will also result in a substantial cost to the bank. During the interviews, it was even suggested that the Basel II requirements may lead to changes in the business model applied in certain areas of banking. Any business model adjustment will change fundamentally the way business is conducted and incur major cost in all three of the areas discussed above.

6.4.3 Cost – benefit of the regulation

Will the overall benefits accrued from the Basel II exceed the costs incurred?

The consensus of the respondents, shown in table 9 (5) is that the benefits of Basel II will exceed the costs. Thirty percent of the respondents opposed this contention. The view of the negative respondents was that the amount of money spent on Basel II is extremely large and although there will be benefits, the scale of the costs will never be exceeded by the benefits achieved. Another concern was that the imported complexity of the regulation is too heavily engineered for the South African situation. South Africa is a market that has substantial social demands and the country specific exclusions do not go far enough in addressing these demands.

However, the positive 70% believe that this statement is true for two main reasons. First, they believe that the banks will be forced to more accurately consider and measure risk which will lead to a better business understanding and if properly managed will provide a saving in capital, benefiting all stakeholder groups. Second, the implementation of Basel II will send a message to the international community that South Africa has stable and well managed banks that understand their business risk. This will ensure continued international correspondent banking relationships with access to foreign funds.

6.5 Financial Services Charter (FSC)

6.5.1 Purpose and contribution to enabling environment

What is the purpose of the FSC?

The documentary research displayed in table 10 (1) resulted in a substantial definition of the FSC. In summary, it defines the FSC as a voluntary transformation charter that extends the principles of the Black Economic Empowerment Act to the financial services sector and provides the framework for implementation. As discussed in section 2.2.3, the report 'Towards a 10 year review' (2003) states that, in 1994, South Africa needed governance, social and economic change to address the legacy of Apartheid. Since then, progress has been made in all areas, and economically, substantial progress has been made in ensuring the macroeconomic stabilisation of the economy (OECD, 2004). In the past few years, the economic focus has moved towards sustaining economic growth to address the economic and social problems of the country (Gouws, 2006). The FSC is part of this focus on sustained growth and will harness the power of the financial services sector to assist with this growth.

The purpose of the FSC , as defined by the respondents in table 11 (1), is the use of enlightened self interest and competitive forces to drive behaviour in the financial services sector towards assisting the government's social agenda and contributing to the transformation of society and the economy. This purpose directly aligns with the goals of the new constitution indicated by Jagwanth (2003) as the transformation of society by responding to the history of inequality and oppression.

The purpose of the FSC is to commit the financial institutions to transforming the areas of:-

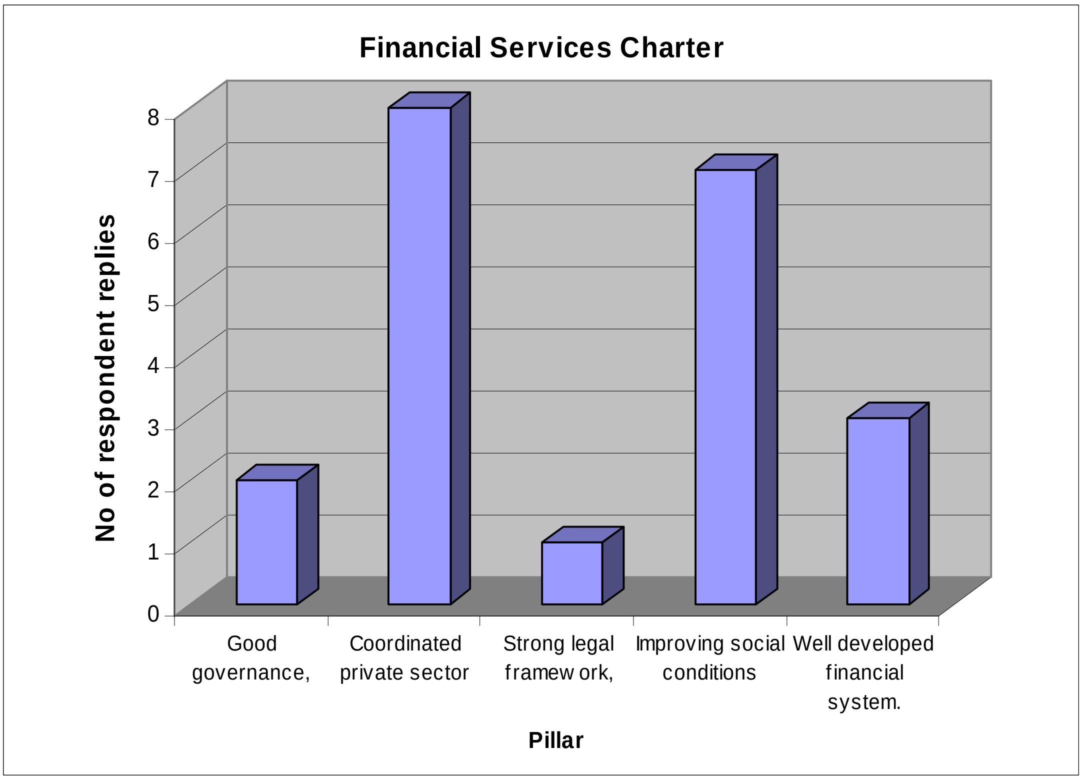
- Human resource development;
- Procurement of goods and services;
- Access to financial services;
- Empowerment financing Ownership and control; and
- Corporate social investment.

How may the FSC make a specific contribution to the enabling economic environment?

As defined in table 10 (2), the transformation of the financial services sector in the above areas will lead to economic growth, development, empowerment and the reduction of inequality and poverty in our society. This transformation will contribute to growing private enterprise as required by Bannock *et al* (2003) in a strong enabling environment, especially in the previously disadvantaged communities and will improve social conditions in the country.

Figure 8 shows that the interview respondents corroborate this contribution with high responses in the area of growing the coordinated private sector and improving social conditions. The respondents indicate that the FSC will make a large contribution towards lowering barriers to entry in the formal sector, greatly advancing skills development, simulating markets that are not the traditional targets of the banks e.g. low income housing and adding previously disadvantaged people to the shareholder base creating vested interests in the success of the economy.

Figure 8: Contribution of the FSC to the enabling environment



Some respondents indicated concern that the environment may be negatively affected because the timeframes allowed for the achievement of targets are too short and that, especially with the human resource development, inefficiency will be protected and discrimination sanctioned. Another concern is the lack of impact in some areas such as the low cost housing. However, despite the concerns, the consensus of opinion was a strong contribution to the private sector and social pillars of the enabling environment.

6.5.2 Benefits and costs

What are the specific benefits and the components of cost of the FSC and which stakeholder groupings will receive the benefit and incur the costs?

The majority of the benefits of the FSC will be received by the customers and the society. As regards the customers, table 10 (3) shows that, as part of addressing the access requirements of the charter, the banks are providing low cost product offerings to the customers, increasing their ability to save and invest. The respondents add, in table 11 (4), that access will be provided to financial products not available prior to the charter provisions. The charter conditions have stimulated innovation in the provision of access to low cost banking services, benefiting the banking customers. The extension of credit to black entrepreneurs incentivised by the empowerment credit guidelines is also a benefit accruing to the customers.

Skilling (2005) defines the mobilisation of savings as an important function of the financial system and this is especially the case in emerging markets that have high investment requirements. In respect of the society benefits of the FSC, table 10 (3) indicates that a benefit of the FSC will be the formalisation of savings, currently outside the formal banking sector, and the channelling of the resultant increased savings pool, by the government, towards targeted investments of national priority fulfilling Skilling’s mobilisation function. As seen in table 11 (4), the respondents add the benefits of improved access, skills development, the development of transformational infrastructure and new business stimulation through focused lending and procurement. These benefits will combine to broaden the market and contribute to the long term, sustainable development trajectory required in South Africa.

The benefits that accrue to banks and shareholders depend on the response of the bank to the charter provisions. The more proactive the banks are in their response to the charter, the higher the benefits for the banks. As detailed in table 11 (4), these benefits accrue through long term market expansion created by addressing different segments and customer bases to generate profitable business. If the banks effectively address these new markets, leverage the charter scoring to obtain corporate business and use the different perspectives of the new employee groupings to generate new business, the FSC will have major benefits to the banks.

The costs of the FSC are predominantly incurred by the banks and the shareholders. Table 11 (4) lists training and recruitment cost, management time and opportunity costs of applying resources to the charter related business areas as the major costs incurred. The details of the costs add to assertion that the response of the banks will determine their success under this legislation. If these costs are seen as part of compliance and not as a business opportunity, they will overshadow any benefit that may be achieved.

The costs to the banking customers flow from the failure of the banks to adequately address the provisions. Inefficient products that do not meet the customers' needs and low product affordability due to the compliance cost being passed through to the consumer, are noted in the responses as costs for the customers. The dilution of shareholder value as a result of the empowerment deals is detailed as the largest cost to the shareholders. Finally, for society, the behaviour linked to the relatively short term target setting of the charter such as tokenism and window dressing in skills development, could limit the benefits of the charter.

6.5.3 Cost – benefit of the regulation

Will the overall benefits accrued from the FSC exceed the costs incurred?

The majority of respondents believe that the benefits of the FSC exceed the costs. As shown in table 11 (5), 70% believe that the benefits of the FSC will exceed the costs. They concede that this view is largely theoretical and that it is difficult to measure but feel that there will be a long term economic benefit from the charter related activities. There is some agreement that the goals of the charter are a business imperative in South Africa and have to be achieved and that the self regulation introduced by the charter is better than government imposed legislation.

The 30% that feel the costs will exceed the benefits believe that the Mzanzi initiative is costing more than the benefits provided by creating new customers and that skills development is not occurring as intended because it is causing counterproductive discrimination. Also, the incorrect setting of the targets has been provided as a rationale. The targets have been too soft in some areas and unrealistic in others, resulting in either too little change or a shortfall against the targets.

6.6 Benefits and cost summary

In order to achieve an overall view of the specific benefits and component of costs across the regulations, the benefits and costs of each regulation are summarised in table 13. The summary includes the key costs and benefits per stakeholder group as indicated by the documentary review and the interview responses.

Table 13: Summary of the benefits and costs

Reg	Stakeholder	Benefit	Cost
NCA	Customers	Consumer protection through more disciplined, structured and accessible credit environment.	Limitation of access to credit especially at the lower end of the market.
	Banks & Shareholders	Better banking practises through improved process efficiencies, renewed customer focus and legitimate pricing.	High once off cost due to reorganisation required of people, processes and systems. Increase in ongoing origination and administration costs.
	Society	Increased availability, affordability and knowledge of credit stimulating savings and developmental borrowing.	Increased costs of operations may reduce the lower end access to credit.
FICA	Customers	Lower criminal activities.	Limitation of access and high inconvenience factor.
	Banks & Shareholders	Reputational protection, increased knowledge of customer and reduced losses from illegal activities.	High once off reorganisation cost and increase in ongoing origination and administration costs.
	Society	Reduction of criminal activity and increase in international reputation of South Africa.	Higher financial services cost and restriction on use of financial services.
FAIS	Customers	Consumer protection through ensuring the high quality of financial advice.	Onerous documentation and higher cost of service.
	Banks & Shareholders	Enhanced reputation, stronger trust relationship with customers and better quality business deals.	Short term reorganisation and training cost.
	Society	Expanded confidence in financial products and protection of vulnerable consumers.	None noted.

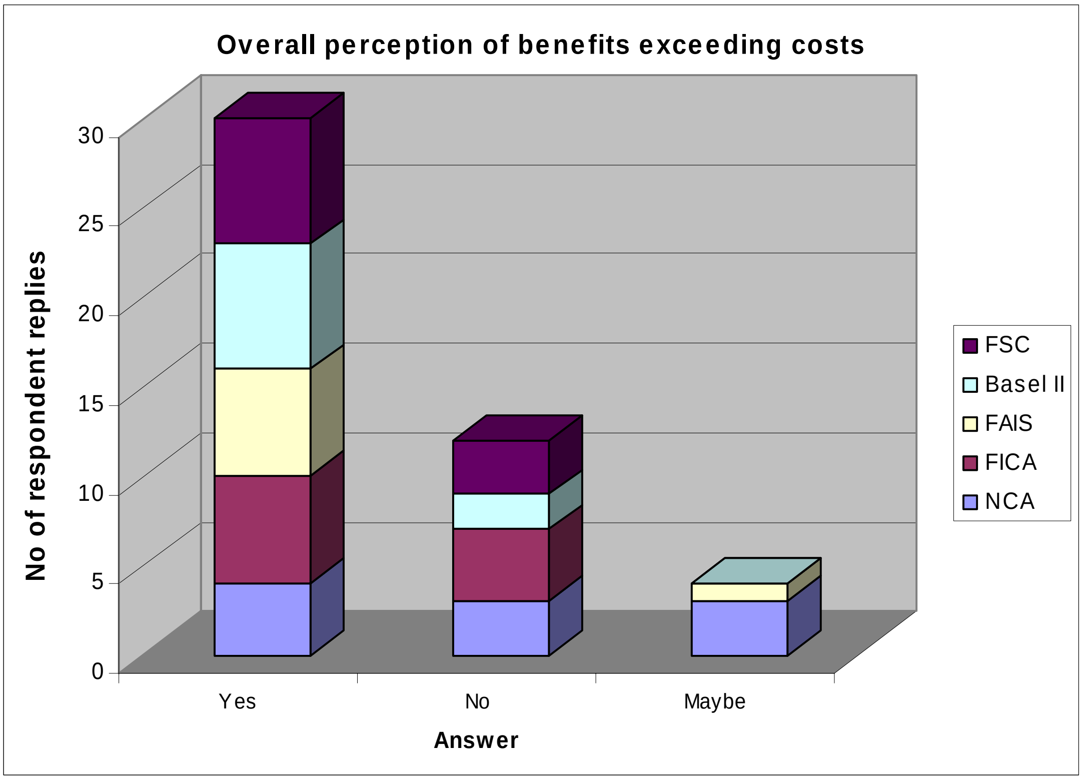
Reg	Stakeholder	Benefit	Cost
Basel II	Customers	Stable and reliable banking system providing appropriately priced products.	Exclusion of certain consumers from access to financial services and potentially higher cost products.
	Banks & Shareholders	International consistency, improved capital management, process efficiencies and better alignment between management and regulators.	Extremely high reorganisation costs in process, people and system realignment.
	Society	Enhanced international reputation and integrated, stable banking system with well capitalised banks.	Internal compliance focus diverts resources from development opportunities and high cost may drive banks away from lower end of the market.
FSC	Customers	Increased access to financial services providing the ability to save and invest.	Inefficient banking products and high cost.
	Banks & Shareholders	Increased focus on new markets produces profitable growth in areas not previously considered.	Opportunity cost of management time and establishment costs of building processes to address new markets.
	Society	Broader, more sustainable and credible economy with a higher level of skills, improved access to banking and a larger savings pool can be applied to developmental projects and transformational infrastructure.	Behaviour linked to short term target setting resulting in tokenism and window dressing and undermining the required benefits.

This overall view of the benefits and costs provides an important basis for the development of the cost-benefits analysis and the achievement of the research aims.

6.7 Overall perception of benefit versus cost

When considering whether the benefits of each of the legislative elements exceed the cost, the responses showed that the opinions were not unanimous. Across all the elements there were both positive and negative responses and some that were conditional on other factors. However, when the responses are displayed as in figure 9, the majority view can be easily identified. The responses indicate an overall opinion that the benefits will exceed the costs with the most prominent 'yes' response for FAIS, Basel II and the FSC. FICA is most negatively perceived while the NCA has a high 'maybe' response due to preconditions required of high economic growth and a change in the culture of society in South Africa

Figure 9: Overall perception of benefits exceeding costs



6.8 Overall contribution of the combined regulation

Is regulation in South Africa banking aligned towards creating an enabling economic environment stimulating economic growth?

As detailed in 2.5 above, Pennington, Lundy and Bowes (2004) believe that the current regulations are part of a holistic plan formulated to address poverty alleviation and economic growth, two elements of the enabling environment. This statement seems to be corroborated by the respondents in this study. As shown in table 12, 85% believe that the regulations are all working towards the enabling environment. However, when the responses are analysed more closely, they show that the rationale given for the answers is heavily skewed towards compliance with international regulation. The 'yes' responses indicate the following as reasons why the legislation is working towards the enabling environment:-

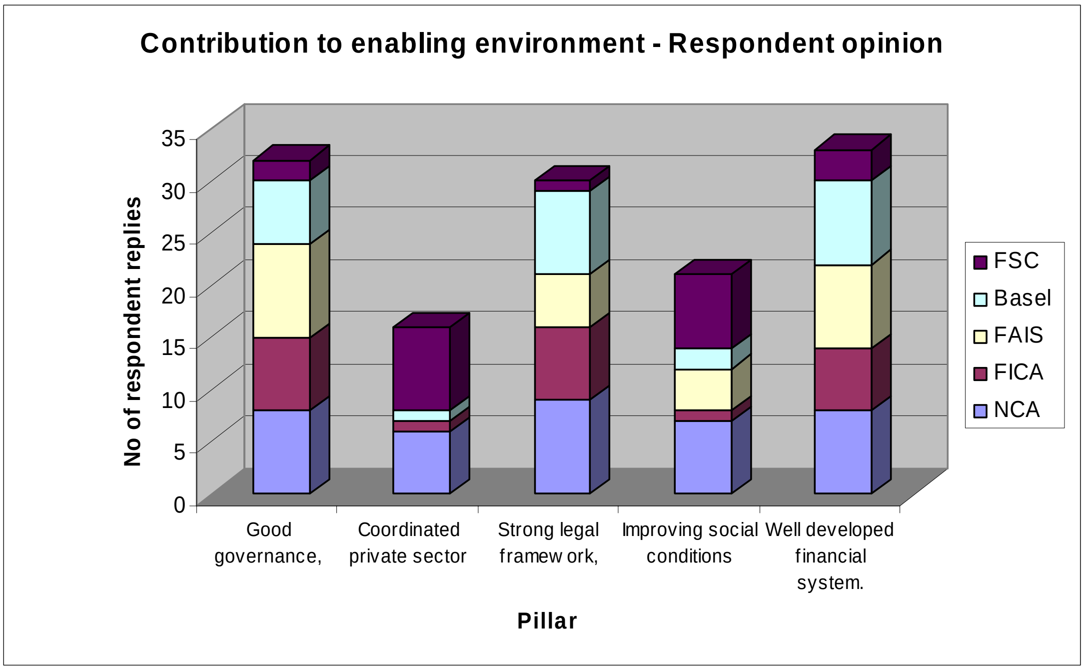
- Good 'conduct of business' guidelines,
- International best practice to foster investment,
- Developing the SA banking system to be comparable with the best in the world; and
- The modernisation of the existing legislation to ensure the best credit rating.

All of these responses indicate international compliance and appear to be based on the governance, legal framework and well developed financial system pillars of the enabling environment. They do not address the access and social pillars.

Tshabalala (2005) included increased competition and access to financial services for the previously un-banked as two elements of the government intention with the regulation. The 'no' responses directly contradict these two intentions presenting the unintended negative consequences of limits on access at the bottom end of the market and raised barriers to entry resulting from the international compliance as reasons why the regulation is not adding to the enabling environment

Therefore, the opinions of the respondents in respect of the contribution of regulation to the enabling environment can be summarised as a major impact in the areas of governance, legal framework and well developed financial sector and low in the pillars of an increased co-ordinated formal sector activity and improved social conditions. This overall view is supported by the views expressed on the individual regulations. Figure 10 aggregates the contribution of each regulation towards the pillars of the enabling environment. This aggregated view clearly shows that the 'social' pillars lag the international compliance pillars in the opinions of the respondents.

Figure 10: Overall contribution to the enabling environment



The conclusion that can therefore be drawn in answer to this question is that the regulations are adding to the enabling environment. They are, however, more focused on the South Africa's compliance to international standards than on the social development of the country. The intention of the South African enabling environment is to facilitate the social and economic development required in the country via economic growth. In order for this environment to achieve its goals, the regulation must, in the future, become more focus on the social and economic development objective.

7 Conclusion and recommendations

7.1 Observations

As detailed in section 2.5, the South African Government's intention is to use banking regulation to contribute towards the creation of an enabling economic environment in South Africa. This study has analysed five legislative elements in order to understand their purpose, contribution to the environment, benefit and cost composition and the extent of these costs and benefits. From the results of this analysis, a number of observations can be made.

Firstly, a conflict exists within the purpose of the legislation between 1st world international compliance and the 3rd world development objectives. In order to integrate into the global economy and ensure that the reputation of South Africa is such that the country is accepted internationally, compliance with certain international regulatory principles such as FICA and Basel II is required. These principles are designed for advanced economies and, by their nature, are exclusive and not inclusive in respect of access to financial services and stimulation of the lower end of the banking market. The development objectives in South Africa are social and economic and require an inclusive and stimulatory impact, created by legislation, which encourages customers to become part of the banking system and use the capital provided to create private enterprise and stimulate growth. The friction between these diverse intentions makes it difficult to create a balance in the promulgation and implementation of banking regulation.

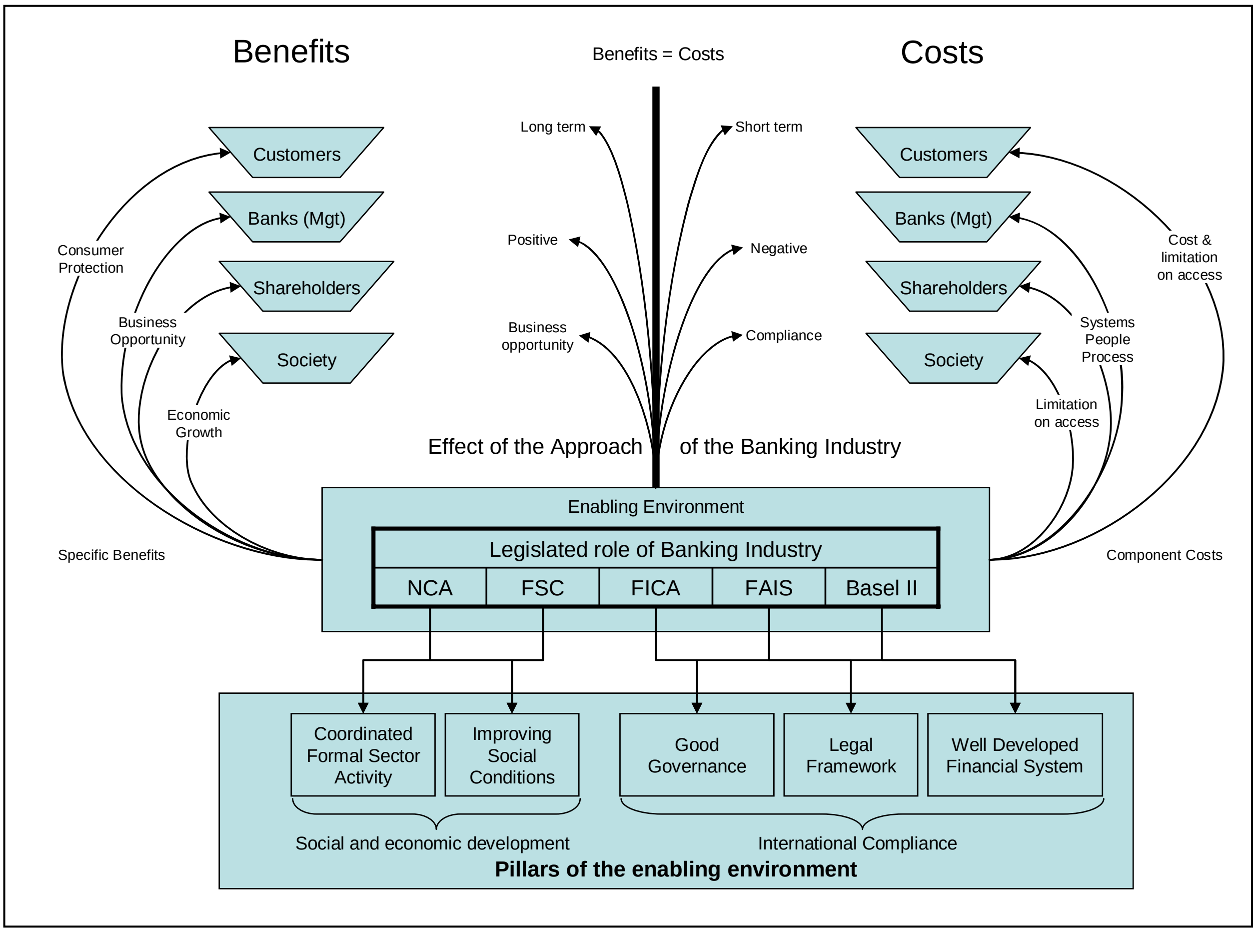
Second, when considering whether the benefits exceed the costs, it is important that a positive, long term, holistic view is considered. This is generally difficult to achieve as costs have an immediate, very visible impact in the short term, results driven, banking environment and the benefits are theoretical, can only be proven after the cost have been incurred and do not necessarily accrue to the banking institutions. Although incurring the costs prior to the realisation of the benefits is no different to the exploitation of a business opportunity such as the introduction of a new product, the implications of incurring of the costs to the benefit of others can create a negative perspective. It is important that the long term macro economic benefit is considered.

Further to this point, the effect of the banks' and shareholders' approach to the regulation is important. Most of the regulation incorporates provisions that can be exploited to the benefit of the banks. It is important for the successful achievement of the benefits that these regulations are seen by the banks as a business opportunity and not a compliance initiative. If the legislation is viewed as a business opportunity and the banking business models are adapted to exploit the various positive provisions, the costs of the regulation will be less significant than if a pure compliance view is adopted.

Finally, the speed and extent of the introduction of the regulations is a concern. The 5 legislative elements are each onerous and expensive to implement and have been introduced during the same time period. This has required a substantial amount of organisational change and high costs to be absorbed by the industry. If this process had been slowed down and a gradual approach adopted, more benefits may have resulted from the undiluted focus each regulation would have received.

7.2 Research model

Figure 11: Research model



The model detailed in figure 11 has been derived from the results of the research. The intention of the model is to summarise the conclusions in a simple, visible framework and to highlight the major findings of the study. It was developed by focusing on each of the three major areas detailed in the study, defining the relationship between the areas and tying the conclusions of the research to each area.

The major areas were defined as:-

- The contribution of the legislation to the enabling environment,
- The specific benefits and component costs of each element; and
- The cost-benefit of the regulations.

The first area required the understanding of how the legislative elements related to the pillars of the enabling environment. This relationship was determined by reviewing each regulation and selecting the pillars that the respondents indicated were predominantly supported by each regulation. The specific benefits and components of cost, detailed in the results, were then reviewed across all of the legislative elements and the major benefit / cost themes against each of the stakeholder groups identified. These themes were then used as a link between the enabling environment and the stakeholder groupings. Finally, the variables determining whether the benefits will exceed the costs were identified in the interview responses. These variables and their effects were then incorporated into the model.

Central to the model is the enabling environment. As detailed in 1.1.3 and 1.1.4, the regulation of the financial sector has a large part to play in the creation of this enabling environment. Therefore, the legislated role of the banking industry and more specifically, the legislative elements are shown within the enabling environment box. The bottom box in the model contains the pillars of the enabling environment as detailed in section 2.4. The first observation in section 7.1 details social and economic benefits and international compliance as the two specific but contradictory objectives of the legislation. Based on these objectives and the definitions in 2.4, the pillars have been divided, in the model, into two groupings showing which pillars support each of these objectives. The legislative elements have been linked to the pillars, which were defined by the respondents as predominantly supported by that element. This link shows how the legislation is contributing to the enabling environment.

The top of the model has been split into 2 sections, with the left side of the model depicting the benefits and the right side, the costs. Within each section there are blocks representing the stakeholders in this regulatory process. On the left, the stakeholder groupings are connected to the enabling environment by arrows representing the major benefits, as shown by the research results, accruing to each stakeholder group. Likewise, the groupings on the right have been connected to the enabling environment by arrows representing the major cost to each stakeholder groups.

The middle section of the model contains a line down the centre which indicates the point at which the benefits of the regulations equal the costs. The three sets of arrows moving away from this line indicate movements in the benefit vs cost equation driven by the approach of the banking sector towards the regulations. The arrows indicate that benefits will exceed the costs if the banks take a long term view of the regulations, adopt a positive approach and treat the implementation as a business opportunity. If, however, they are negative and focus on the short term, approaching implementation with a compliance mindset, the costs are likely to exceed the benefits. This observation makes the management of the banking institutions an extremely important partner for the government in the achievement of the objectives and, without their assistance, the conditions of the enabling environment will be difficult to achieve.

The model is helpful to summarise the relationships between the regulations and their effects and demonstrate the complexity of the opportunity created by the legislation.

7.3 Recommendations

This research was exploratory in nature and aimed to understand the intention and cost benefit of certain banking industry regulation. It was a high level study that did not seek to resolve any particular issues but rather expose issues related to the regulation.

7.3.1 Government

The government of South Africa, through the various organs of state, is responsible for the promulgation of this legislation. Three recommendations based on the results of this study, are relevant to the government's introduction of the legislation.

The first recommendation centres on the international compliance facilitated by the legislation. The model shows that more of the legislation is focused on this objective than the objective of social and economic development. A number of comments were also made in the interview responses that the regulation has been too puristic in its implementation and gone too far in trying to achieve its international compliance objectives resulting in an overreach that has negatively affected the social objectives required in the South African scenario. The recommendation is to ensure that all legislation, aimed at the objective of international compliance, contains relevant and required ‘South Africanisations’. Where possible this compliance legislation should be applied at a level that allows it to complement rather than detract from the social requirements. The exclusions and exemptions included in the regulations such as the NCA and FICA should be extended to ensure that the correct market segments are positively affected and the negative impacts, especially at the lower end of the market, are reduced.

The second recommendation is that more work is required to facilitate the social and economic requirements of the enabling environment. The model shows that the regulations are definitely skewed in favour of the international compliance and the overall effect is not conducive to creating the conditions for economic growth.

Finally, more must be done to integrate the regulations into a strategy that is consistent and well communicated. Currently there is a perception that the regulations are too frequent and haphazardly implemented. A strategy that positions each piece of legislation in an overall roadmap, communicated to the relevant stakeholder groups, will counter this perception. The model shows the 5 legislative elements that have been release in the recent past. This frequency of introduction must also be reduced. The banks and their shareholders are being asked to incur most of the costs for the benefit of all the stakeholder groups. There is a limit to the cost that they can afford or are willing to incur for the greater benefit of other stakeholders. If current pace of regulation continues, the effects will start becoming negative and not conducive to the conditions required to support the enabling environment.

7.3.2 Banks

A high level study of this nature does not result in detailed recommendations as to how the banks should approach the legislation. This approach will be specific to each bank and will vary depending on the nature each institution. The results, however, do show that it is the approach of the banks towards the regulation that will determine the successful achievement of the benefits.

The recommendation for the banks is that they define their approach to the regulations with a business opportunity mindset and not with a focus on pure compliance. If implementation of the regulations includes incentives for management to obtain business benefits, the cost elements are easier to motivate and absorb and the organisation will benefit along with the other stakeholder groups. The approach must also be long term in its vision. The benefits will not be realised immediately and banks must plan long term to see the benefits justifying the high implementation costs.

Finally, of vital importance, is the continued engagement of the banks with government in the consultation process. The extent of banking industry involvement in the National Credit Act and the Financial Services Charter ensured that the conditions were fair, achievable and beneficial to all stakeholders. Such involvement is key to the creation of a situation in which all stakeholders can benefit.

7.4 Recommendations for future research

The topic of banking regulation and its benefits is extremely broad. The scope of this research report was restricted to certain questions and respondents in order to ensure that it was limited and specific. However this restriction has highlighted a number of areas in which future research can be performed. These include:-

- The banking opinions in the study were restricted to one, 'big four' banking institution. The study could be extended to other banking institutions, the reserve bank, policy makers and other stakeholders to validate whether the opinions are similar across the industry;
- In the early 2000's a number of banking institutions relinquished their banking licences. The regulations imposed on the banking industry at the time were somewhat responsible for this reduction of banking institutions in the country. A study within these organisations as to the reasons for this surrendering of the licence and effects of the regulation on this process will reveal a different side of the regulatory impact;
- Due to the required limitation of scope, the Banks Act was excluded from this study. The Banks Act is the legislative framework within which all other banking related legislation is promulgated. Some of the respondents indicated that it has a highly protectionist impact on the banking environment and actually raises barriers to entry. A study could be undertaken to understand how the changing framework of the Banks Act is affecting the enabling environment and how the benefits resulting from the legislation, covered in this study, are affected by the provisions of the banks act;

- The implementation of the legislation covered in this report is either completed or in the final stages. The banks are starting to release the costs of these implementation projects to the public. Another potential research area is to understand the actual costs of the regulations and to try and quantify the potential benefits in order to perform a financial cost-benefit analysis either of one of the individual elements or the regulation as a whole; and
- Finally, due to the protectionism of the Banks Act and the reduction in the number of banks, competition in the industry has reduced. Combine this with the relatively high bank charges prevalent in South Africa and a strong case can be made that more needs to be done to stimulate competition and drive down the costs of banking. This stimulation of competition in the banking industry and the effect on the enabling environment could be explored with further research.

7.5 Conclusion

The creation of an enabling economic environment will provide conditions that encourage private sector activity and enterprise development and place the economy on a long term sustainable development trajectory. Such an environment will provide the economic growth to address some of the social and developmental problems in South Africa. The size and essential economic function of the banking industry make it central to the creation of these conditions and therefore the government’s intention is to use regulation in the banking industry to assist in the creation of the conditions of an enabling economic environment.

This study has analysed 5 of these regulations to determine whether their purpose is aligned with this goal, whether they fit into the enabling environment, what the component of benefits and costs are and whether they will be successful with the benefits exceeding the cost.

The analysis of the purpose of each regulation and their contribution to the enabling environment showed that they each have a different role to play in the overall regulatory environment. They all address the pillars of the enabling environment notably split between those that support the international compliance pillars and those that contribute towards the social and economic benefits. In line with the overall intention, the benefits are consumer protection and the enhanced stability, access and use of the financial system. The benefits are largely accrued by the banking customers and the society of South Africa. The costs incurred relate to major reorganization of the banks' operations in order to fulfill the requirements of the legislation. This major reorganization cost also leads to higher cost in the provision of services especially to the lower end of the market. Therefore, the majority of the costs are incurred by the banking institutions and, for the society, there is a cost at the lower end of the market that counters the benefit of access.

The ultimate success of the environment will depend on whether the benefits created by the legislation will exceed the costs. The results of this study show that in the long term, benefits should exceed the costs and that the regulations will be successful. However, due to the mismatch between where the benefits are accrued and where the costs are incurred, and the first world nature of the international compliance requirements, there are provisos to this conclusion.

Firstly, the banks need to show benefits to their shareholders related to the high cost of these initiatives. There are provisions in the legislation that will allow the banks to benefit from the implementation of the regulations. If the banks approach the regulations with a positive attitude and see them as a business opportunity, they will be able to exploit the provisions and provide benefits, not only for themselves and their shareholders, but also for the rest of the stakeholders. If they take a negative, compliance only mindset, the costs are in danger of exceeding the benefits and the overall development goal may not be achieved. Second, by their nature, the international regulations conflict with the social development objective required in South Africa. These regulations must be adequately modified to ensure that effective exclusions protect the development objectives

Overall, the regulations support the government intention to create an enabling economic environment. The benefits defined in this study indicate that the regulation is facilitating the creation of the enabling conditions. However, the complexities and cost of implementation have the ability to eliminate the benefits. Provided the banks can be convinced of their leading role and supported by the government and that a functional balance can be achieved between the international compliance and social and economic development objectives, the regulation will provide the conditions required in an enabling economic environment.

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9 Appendices

9.1 Appendix A: Interview guide

<u>Contextualisation</u>

Research Problems

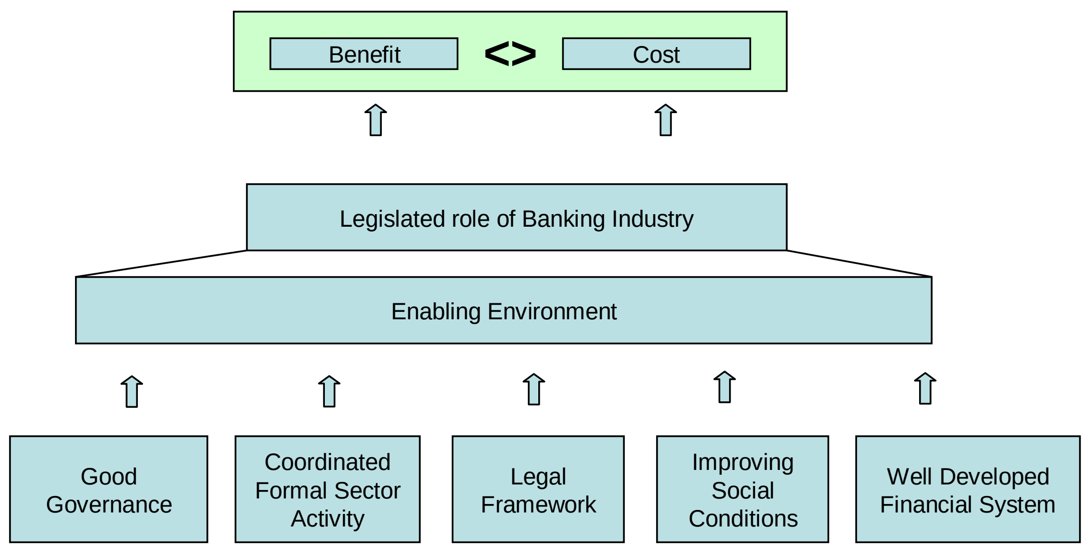
- The impact of banking regulation on the enabling economic environment
- The cost benefit of South African Banking Regulation

Definition of an enabling economic environment

- An enabling environment provides conditions that encourage the growth of private sector activity and enterprise development and place the economy on a long-term, sustainable development trajectory.

- A successful enabling environment has conditions that ensure
  - good governance
  - coordinated formal sector activity with low barriers to entry
  - a strong legal framework
  - improving social conditions
  - and a well developed financial system.

Components of the enabling economic environment



#	Interview Guide - Questions
	Establish Field of Expertise
1	Which of this list of regulations are you able to comment on? (Use tick list in appendix B)
	Define Enabling Environment
	Explain the component parts of the enabling environment
	Questions per Legislative Element
2	What do you believe is the purpose of this legislation?
3	In context of the enabling environment, how do you think this legislation is adding to the enabling environment,
4	Which element is it supporting? (Use Tick Box)
5	What are the benefits that will be produced by this legislation and to whom will they accrue?
6	What are the costs of this legislation and who will incur these costs.
6	Do you think that the benefits will exceed the costs? (Yes / No / Maybe)
6	Why?
	Repeat for all selected regulation
	Overall contribution of the combined regulation
2	Do you believe that the overall regulation in South African Banking is working towards creating an enabling environment? (Yes / No)
2.1	Why ?

9.2 Appendix B: Schedule of intervie

Interview Details			Interview Coverage				
Category	Name	Function	NCA	FICA	FAIS	Basel II	FSC
Bank Official	Dave Hodnett	Director , Retail Credit	√	√	√	√	√
Bank Official	Norbert Hoffman	Director, Capital Management	√	√	√	√	√
Bank Official	Coenraad Jonker	Director, Low Income Banking	√	√	*	√	√
Bank Official	Marna Roets	Director , Group Financial Accounting	√	√	√	√	√
Bank Official	Sim Tshabalala	Managing Director, Retail Bank	√	√	√	√	√
Commentator	Penelope Hawkins	MD Feasability	√	√	*	√	√
Commentator	Leon Kirkinis	CEO Africa Bank	√	√	√	√	√
Commentator	Richard Stovin-Bradford	Banking Journalist	√	√	*	√	√
Commentator	Bob Tucker	Ex banking council and Director of low income banking.	√	√	√	√	√
Commentator	Grietjie Verhoef	Professor of Historical Studies	√	√	√	*	√

* Interviewee elected not to discuss the regulation due to limited knowledge.