CEOs' report

"Our unique business philosophy and structure will ensure that FirstRand is better positioned than most to continue delivering superior returns to shareholders."

Paul Harris and Laurie Dippenaar

Unpacking FirstRand's unique value proposition

During the year we decided to benchmark how effective we have been at communicating to our shareholders. We commissioned two surveys amongst analysts, investors, media, and other opinion formers in the broad investment community. We learnt a great deal.

Of interest was a frequent comment that FirstRand's proposition appeared somewhat complex and confusing.

The fact is that FirstRand is actually a very different proposition to its peers in the financial services arena and the perception of complexity is probably a result of the unique way we structure and run our business.

In an attempt to bring clarity we have therefore utilised this year's communiqués to our shareholders to proactively address these perceptions.

We acknowledge that for a listed company to be significantly different to its peers makes the professional analyst and investor's life difficult in so far as conventional models are no longer applicable, and it seems to have put FirstRand at a disadvantage. And yet, to be 'differentiated' in a traditional marketing sense, is considered to be a significant competitive advantage.

We intend to use this year's report to explain how the very "difference" in FirstRand is its biggest strength and why we believe it will enable this group to continue to deliver superior growth going forward.

Integrated Financial Services – what does it mean?

FirstRand is the only fully integrated financial services group in South Africa.

It means that we have access to all the building blocks such as brands, client bases, distribution networks, IT systems, etc. required to play in the financial services arena and we are able to arrange and leverage off those building blocks in any way we can so as to get the maximum business advantage.

Why a federal structure versus a monolith?

Now let's deal with that unique structure, which we describe as a confederation of profit centres that serve various parts of the financial services market. This structure is successful because it allows FirstRand to function as a number of small focused businesses that can find and swiftly exploit profitable niches, whilst at the same time enjoy the financial muscle and operational critical mass of the Group.

Each profit centre has its own strategy and its own highly motivated management team, unburdened by bureaucracy or corporate red tape, empowered to drive the business forward. In addition these separate businesses are focused on their particular niche, with all the necessary expertise and judgement to formulate an appropriate strategy. Each business is often supported by its own individual brand, designed and positioned to service that specific customer base.

FirstRand therefore does not have a centralised command and control structure that seeks to force strategies from the centre. The Group ensures that the individual strategies are co-ordinated and compliment each other, that the necessary resources such as capital and skills are appropriately allocated, that there is no duplication and that all possible synergies are identified and maximised.

However, size does matter in the financial services market. There are considerable advantages to being big. The significant balance sheet of the Group provides financial credibility that is essential in the financial services arena. In addition, the infrastructure provides significant leverage opportunities to the various businesses.

What are these things called clusters?

The research that we undertook fed back to us that the cluster structure was a difficult concept to evaluate – particularly as it had blurred the lines between the traditional financial services silos of Corporate Banking, Retail Banking, Insurance and Asset Management. We want to stress here that the FirstRand view of the world is market segments and we believe that the clusters are the most appropriate way to co-ordinate the segment approach and we will explain in more detail why this is key. However, we are cognisant that the professional analyst and investor have to model this business against our peer groups. Therefore we have provided detailed disclosure of the results of the operating businesses that form the clusters.

The segment approach

Going back to the clusters, whilst the individual profit centres are in the main independent operators, they are also interdependent with other profit centres and where they are serving the same customer base, i.e. retail customers, they need to be strategically aligned. This is where the clusters come in. We have segmented our markets into the four areas of Retail, Corporate, Wealth and Health.

The clusters provide the strategic framework for the businesses servicing each of those markets. This structure facilitates the right level of focus on a market and is skilled-up appropriately. It also facilitates collaboration, which at FirstRand is not a narrow concept. Cross selling is just one aspect of the capability of the clusters. Because we are fully integrated each profit centre can leverage off the entire infrastructure of the Group.

Collaboration also happens across clusters. Examples such as WesBank's penetration of the FNB Corporate customer base to grow its book by a further R2.3 billion over two years demonstrates that significant growth can be created through leveraging off the infrastructure of this Group.

A different structure created by a special business philosophy and culture

The FirstRand business philosophy has been home-grown, developed and ingrained into all the Group's businesses over the past 25 years. It has its roots in an entrepreneurial culture.

At its heart is the understanding that people are the single most important resource and FirstRand aspires to create an environment that attracts and retains entrepreneurial self-starters.

Although there is a bias for action, the Group aspires to act within the context of clearly thought-through strategic and operational plans, hallmarked by new paradigm and innovative thinking, but which makes bottom-line sense. Structure follows strategy.

Participative, non-hierarchical decision-making in the context of vigorous debate of the business case, with no holy cows and no barriers to communication, lies at the core of the way it does business.

This is the common value system on which the entire Group operates. This philosophy creates a liberating owner-manager culture. Strategies are owned and delivered on by the profit centre leaders because they conceived them.

The Group's approach to branding is directly related to our de-centralised owner/manager philosophy and now comprises a portfolio of complementary, best of breed brands within all the markets the Group serves.

So how does all this help us grow?

We are constantly faced with the question "how can FirstRand sustain its performance?" The answer to this question in a FirstRand context is not that simple. Why? Because there is no single, easily articulated or quantifiable theme we can offer investors.

The growth story is at the individual business level, however FirstRand, at the centre, does provide certain generic guidelines going forward and we see five key ingredients to our growth strategy.

Classic **organic growth**, which means doing the same things more efficiently and smarter than the year before – a case of continuous improvement.

Through **acquisitions**, which is a core competency of the FirstRand Group, whether mega acquisitions or, as we have favoured lately, small bolt-on acquisitions that provide us with load for our existing infrastructure.

Another core competency of the Group is **starting entrepreneurial new ventures**, such as OUTsurance, Discovery, eBucks.com and RMB Private Bank. The impact of these businesses is often under-estimated, however in the year under review these four businesses, started in the last five to ten years, delivered 4% of the Group's 23% core earnings per share growth. Put differently, without them, our growth would have been only 19%. Although they contribute a relatively small percentage of total profit, the phenomenal growth rates resulted in them contributing a disproportionate share of our total growth.

Looking to new markets, whether in Africa or abroad and whilst on the subject of international operations, we would like to clarify the FirstRand international strategy.

A group as diverse as FirstRand cannot be replicated in any one country. Therefore we have a 'rifle shot' approach to international expansion. We are a "Rand Specialist" and we do not have a specific target for off-shore income which we wish to achieve. More importantly our off-shore strategy whilst prioritised and co-ordinated at the centre is driven at business unit level. Any proposed off-shore expansion must have a strategic fit with the business unit's domestic strategy and the business unit expanding overseas must be able to demonstrate a substantial competitive advantage.

An example of this is FNB Retail's strategy in Africa. There are compelling reasons for focusing on Africa. Our current retail banking operations deliver ROE's in the mid thirties and have achieved excellent compound annual growth rates in earnings. We plan to expand further into Africa, focusing on selective jurisdictions. We have an open mind in terms of whether we take a grassroots approach or acquire either a single branch or a network of banks.

Finally, **collaboration**, which we have already covered.

Within these broad parameters every one of the Group's many profit centres has a strategy to grow market share, revenues and earnings. Each CEO is empowered and incentivised to deliver better than his/her budget at the end of the year. Our structure and business philosophy means that FirstRand has many growth stories for 2004 and onwards.

Our growth record

Has FirstRand's unique value proposition delivered results? A leading stockbroking firm did an analysis of earnings per share growth rates of the top 100 companies, by market capitalisation, listed on the Johannesburg Securities Exchange South Africa which have a ten year profit history. The analysis showed that FirstRand (formerly Momentum) ranked first, with a ten-year compound earnings per share growth of 40% per annum.

The past year's big agenda items

Moving on to some of the more important strategic initiatives that occupied us in the past year.

During the year we announced our decision to disengage from Ansbacher (UK). Following a strategic assessment of our international operations, we came to the conclusion that certain businesses in the Ansbacher Group have become increasingly non-core to our overall strategy. Furthermore we believe that Ansbacher requires a strategic shareholder to support its need to pursue an international expansion strategy to develop critical mass in its distribution channels.

The successful conclusion of Destiny Health's joint ventures with Guardian and Tufts in the USA is, we believe, a turning point in Discovery's international strategy.

Discovery has pursued a brave and aggressive international strategy in the most competitive and sophisticated health insurance market in the world, the United States ("US") and these joint ventures will provide the brand credibility and distribution reach which Destiny has lacked so far. Destiny is making steady progress to the magical mark of 30 000 lives covered which is the number of lives it believes is required to break even which is targeted for early 2004. To support the roll out of the US joint ventures, Discovery embarked on a capital raising initiative and successfully raised R875 million by way of a claw-back offer, underwritten by FirstRand.

Next year?

A positive picture is emerging for next year. The macro picture is looking more positive with the prospects of an improved economic outlook in the year ahead. Lower interest rates will benefit growth and increase the likelihood of a favourable movement in the stock markets. The benefits of a lower interest rate environment should improve credit demand.

The micro picture is also looking good. In terms of this year's problem areas, we are expecting significantly improved results from RMB Asset Management in 2004. Investment markets appear more promising, relative investment performance is looking good and we do not expect to have the one-off knocks that we had in 2003. We are working hard at finding new shareholders for the whole or parts of Ansbacher.

The rest of our businesses are in good shape, the details of which are covered in a significantly 'beefed up' review of operations, which follows this report and we expect our greenfields businesses, eBucks.com, Discovery, RMB Private Bank and OUTsurance, to continue growing very strongly.

In conclusion, we hope we have illustrated how our unique business philosophy and structure will ensure that FirstRand is better positioned than most to continue delivering superior returns to shareholders.

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15 September 2003