entrepreneurship

The Group's strategy to grow in Africa reflects its culture of entrepreneurship, as it prefers to start its own businesses and grow incrementally.

– SIZWE NXASANA

CEO's report

Sizwe Nxasana

CEO

A performance built on a sustainable strategy

FirstRand's diverse financial services portfolio produced a strong performance for the year to June 2011. I am extremely pleased with this performance which I believe reflects the quality and resilience of our operating franchises, FNB, RMB and WesBank, all of which produced strong profit growth and returns, reflecting the benefits of their respective growth strategies, both in South Africa and Africa. A detailed explanation of our financial performance can be found in the COO & CFO's report on page 16.

Last year in this report I spent a little time on how we have "hard-wired" the issue of long-term sustainability into our strategic thinking. The Group's ultimate objective is to "create long-term franchise value and deliver superior and sustainable returns to its shareholders" through its strategy to be the African financial services group of choice – for customers, staff and shareholders. When we look at how this strategy manifests across the franchises, there are some key "engines" we focus on as outlined in the table below:

Franchise	Customers	People
To be appropriately represented in all significant earnings pools. Deliver superior financial performance. Maintain financial strength. Strive for excellence in execution.	Drive excellence in customer service. Grow customer bases profitably. Deepen our relationships with existing customers.	Become the most sought after employer and improve diversity.

In the operational reviews on pages 30 to 46 there are explanations from each franchise as to how they are "driving these engines", however at a broader level I would like to cover one in particular – to be "appropriately represented in all significant earnings pools".

The Group is already a very large player in its domestic market and given the subdued growth scenario in the South African economy current, which is expected to continue for the next two to three years, revenues will remain under pressure. Despite its size, however, there remain areas of the domestic market where the Group does not have its "natural" market share, and these pockets of growth are where we continue to focus our efforts.

FNB's EasyPlan strategy has received a great deal of air time during the year. However, it is important to remember that FNB had already been operating successfully in the mass market for many years. Before it even commenced with EasyPlan it had built a very solid franchise of over three million customers on the back of a transactional banking offering represented by its Smart product line. However, it did recognise that its lending in that market was behind some of its competitors, and it was this recognition that resulted in EasyPlan.

EasyPlan is not only a lending strategy, it is supported by a strong transactional banking platform with many innovative electronic channels such as cellphone banking and the Automatic Deposit Terminals ("ADTs") (ATMs where customers can deposit cash or pay bills and which is reflected immediately). These channels are ideally constructed for customers who want cheaper and convenient ways to transfer money and pay their bills. There is no doubt that EasyPlan is contributing to customer acquisition, balance sheet growth and the increase in transactional volumes and revenues, and therefore a good example of a new "earnings" pool.

The other initiative I want to cover here is our strategy to grow in the large corporate space. Previously the Group serviced its large corporate customers through two separate franchises FNB and RMB. FNB Corporate offered transactional banking products and services whereas RMB provided pure investment banking. However, ultimately this was not a sustainable structure as our customers increasingly required a more integrated interface and we were definitely not providing an optimal offering to those customers.

As a first step to resolving this issue, last year FirstRand merged the relationship management teams of FNB and RMB to create an integrated client coverage capability and placed them under common leadership at RMB. This has already yielded benefits across the corporate and investment banking ("CIB") activities of both RMB and FNB. This year we completed a strategic review of the Group's corporate transactional banking activities and this resulted in FNB's Global Transactional Services ("GTS") also moving to RMB. This we believe will ensure that all CIB activities are integrated at a client and product level. Alan Pullinger, CEO of RMB, is now also head of CIB with FNB GTS reporting to him. It is early days but we believe these initial steps will drive good growth in the corporate banking segment, where we are currently under-represented relative to our size and quality of franchise. This initiative is a very important one in that it also reflects the key "customer drivers" of delivering excellence in customer service, growing customer bases profitably and deepening our relationships with existing customers.

Innovation – differentiating us from our peers and key to growth

In last year's report I covered in some detail two topics I believe to be key to FirstRand's future success - our owner-manager culture and transformation. This year I would like to cover the remaining two – innovation and franchise value.

As we state in our business philosophy on page 2 of this report, we strive to ensure that innovation is the hallmark of our strategic and innovative plans. We have been incredibly consistent in our assertion that innovation is a pillar of our business and a differentiating factor in our overall investment proposition. It's probably fair to say that many commentators have been sceptical about how meaningful innovation can be to the bottom line, until now that is.

During the golden years of banking, which ended pretty abruptly with the credit crisis in 2008, there was so much natural growth in the financial system, innovation, customer service and other such differentiators seemed to get lost in the frenzied growth. This has now changed as in times of economic pressure, customers look for value for money and helpful innovations. Therefore in the new era we find ourselves in, we believe that innovation can create serious competitive advantages and strong sources of customer acquisition and retention.

What is true is that innovation can only really happen in an organisation that takes it seriously and creates a culture that allows it to flourish. At FirstRand our owner-manager culture, which is so empowering in its expression, has resulted in the appropriate culture of innovation. So what are the main characteristics of such a culture? I see them as follows:

- forgive/allow mistakes;
- don't protect old ways of doing things;
- be prepared to cannibalise;
- people closest to the issue come up with the best ideas;
- the best ideas come up from the bottom – not from the top; and
- acknowledge, celebrate and reward.

It is globally recognised that Apple is one of the most innovative companies in the world and I found a quote on his philosophy on innovation from the late Steve Jobs, the founder and former CEO.

"Innovation comes from people meeting up in the hallways or calling each other at 10:30 at night with a new idea, or because they realised something that shoots holes in how we've been thinking about a problem. It's *ad hoc* meetings of six people called by someone who thinks he has figured out the coolest new thing ever and who wants to know what other people think of his idea… we are always thinking about new markets we could enter."

This comment resonates with me in that at FirstRand and all its franchises, including FNB, RMB and WesBank, the culture of innovation is definitely anchored around constantly thinking about new markets and innovative ways to service customers. FNB recognises that there needs to be a "new way" and I believe the culture is to ignore legacy thinking, focus on designing a product that best suits new markets and drive inclusive growth. FNB's overall growth strategy has always been to enter new markets and capture new customers with innovative solutions designed specifically for the needs of those customers and innovation has been particularly key to the success of FNB's Mass segment strategy. Cellphone banking was a significant early contributor to the success of its transactional banking offering in the Mass segment and the ADTs that I mentioned earlier are now contributing to the acquisition of EasyPlan customers.

Also, no one waits for ideas to come from the top. It is often the young, not the grey beards, who see things differently, and there has to be a way for them to contribute. One of the ways FNB facilitates this contribution is through FNB Innovators, an internal competition started in 2004 which is designed to formally encourage and support the process of innovation, whilst also helping to build innovation-related competencies internally. During the period 2008 and 2010, the top 50 FNB Innovator finalists added R1.35 billion to FNB's bottom line. During the same period, for every R1 spent on the innovations that made it to the Top 50, a R28 return was generated.

It is also very true that people closest to the issue come up with the best ideas. That is why in addition to FNB Innovators FNB developed its "Minivations" programme to further drive innovative thinking into the business.

A Minivation is an innovation that takes no longer than 3 months to implement. It is therefore typically a smaller innovation however when combined, the cumulative impact of Minivations in terms of helping realising FNB's strategy is significant.

A winning Minivation is awarded eBucks. Out of the 256 Minivations logged since inception in the 2011 financial year, just under a third were deemed to be winners by the respective business units and segments. Most Minivations tracked resulted in 'improved efficiency' or 'improved customer experience' and savings and revenue generated that we are able to account for in relation to Minivations for the 2012 financial year are currently expected to be over R30 million.

Building our franchise in Africa – patience and incrementalism required

In his chairman's statement Laurie comments that there are very compelling reasons for FirstRand to grow in Africa and that our approach will be an incremental growth strategy in the main, a mixture of greenfields, bolt-on acquisitions and larger acquisitions only within a very strict risk framework.

He also comments that we are not prepared to significantly dilute our returns to shareholders in the process. To confirm that assertion, the table below shows that, although expansion is currently diluting the returns we generate from our existing businesses, this level of dilution is acceptable given the growth we expect to generate and the overall ROE remains well within our target range.

Ultimately we aim to build integrated or universal platforms with scale, distribution and deposit franchises as this will deliver sustainable long-term ROEs. To this end the current strategy represents the following activities:

- Accelerate the establishment of comprehensive universal banking operation in existing subsidiaries by ensuring RMB "on-the-ground" presence in established FNB subsidiaries – for example RMB FICC teams deployed into Namibia and Botswana.
- Progressively increase our risk appetite as we prove our capabilities.
- To enter new countries through acquisitions and greenfields as appropriate – for example FNB opened for business in Tanzania and RMB established representative offices in Angola and Kenya.
- Leverage the South African balance sheet by increasing our wholesale credit country limits for cross-border activities in our chosen markets.
- Devise a comprehensive strategy to follow our corporate customers who are also expanding into Africa and actively mine our India-Africa and China-Africa corridors – for example strong deal flow generated for RMB during the year across many African territories and sectors.

RMB continues to leverage off our MOU relationships with China Construction Bank ("CCB") and CAD Fund (China-Africa Development Fund) for our China/India-Africa corridor strategy, which have resulted in a number of deals being consummated. We have also signed a cooperation agreement with The Export and

R million	Advances	Deposits	Profit before tax	ROE %
FNB Namibia	12 623	13 315	788	25
FNB Botswana	7 932	11 156	674	42
FNB Lesotho	126	625	12	18
FNB Swaziland	1 343	1 768	117	25
Established franchises	**22 024**	**26 864**	**1 591**	**30**
FNB Zambia	230	491	(62)	(54)
FNB Mozambique	577	825	(5)	(3)
FNB Tanzania	–	–	(16)	(31)
New franchises	**807**	**1 316**	**(83)**	**(22)**
Africa franchises total	**22 831**	**28 180**	**1 508**	**23**
FNB Africa head office/support	–	–	(48)	(>100)
Total	**22 831**	**28 180**	**1 460**	**21**

Statutory view for subsidiaries shown in table above (including FNB Africa and RMB FICC Africa). Figures are shown pre-minorities and pre-allocations to other franchises.

Import Bank of China ("Exim") in areas of infrastructure projects, mechanical and electronic products, energy, construction, raw materials and mining. The relationships with CAD Fund and Exim are complementary (and not in competition) to our relationship with CCB as these are Chinese government policy banks which are more active in the China-Africa corridor than commercial banks.

So, to sum up, to steadily build out our franchise in Africa, we can acquire, and we can grow organically. All of these options are available to us, and we will execute on all of them.

In Nigeria, current dynamics around consolidation suggest that we would need to make an acquisition, however, as indicated by the termination of our recent talks, we will only do a deal if it makes sense. We are constantly assessing the opportunities available and given how much progress the regulator in Nigeria has made, we feel that more, not less, options continue to be available to us.

Looking forward – it's easy to become gloomy

The operating environment going forward is expected to be characterised by low growth. We have revised our GDP growth numbers down to an average 3.0 – 3.5% for the coming year with risk to the downside, particularly if we get another global financial shock. We anticipate flat interest rates through 2012 and possible cuts if the Rand strengthens, growth risks increase and inflation peaks. Real house prices are likely to remain flat with some downside risk due to the current supply overhang and we expect that real wage increases will continue to moderate and private-sector employment growth to be subdued.

Given this scenario, credit growth is expected to continue to lag nominal GDP and consumption spending will remain the main driver of growth with investment spending remaining slow. This means that retail credit growth will continue to outpace corporate credit growth.

These are the realities that we are facing up to, the "new normal" that we are now operating within – a world of lower growth and more frequent shocks. We have been managing our business to this "new normal" for some time and on page 16 Johan Burger in his COO & CFO's report provides further insight into the actions we have taken to ensure the Group weathers the headwinds we see ahead.

Given the weak economic conditions we are grappling with, improving cost efficiencies whilst investing for growth continues to be an important factor for the Group. In the past driving cost efficiency was by nature not a topic which excited people at FirstRand where revenue growth is typically more exciting, especially if it is driven over a long period of time where "cost reduction fatigue" may set in. However, we cannot afford to "take our foot off the accelerator" in this regard and the trick is to excite people and embed efficiency drives in our DNA as part of doing business. I believe we have made significant progress in this regard and in the operational reviews on pages 30 to 46 it is clear to see that the management teams of the franchises continue to apply their minds to this issue.

So to coin a phrase from one of my colleagues, looking forward I remain very "cautious" about the macro environment but "bullish" about our businesses. Our franchises are in great shape, their growth strategies are delivering and the quality and resilience of their businesses are demonstrated in this year's performance and we expect that to continue in the coming year. I would like to extend my congratulations to every single person who works for the Group for a job well done!

Sizwe Nxasana
Chief executive officer