

Operational review: Personal & Business Banking

Overview

The group's Personal & Business Banking franchise continues to develop, a process facilitated by the economic tailwind in the South African market. Over the past three years the division has rebuilt its domestic market shares across most deposit and loan categories in line with its branch representation, and its systems and processes continue to be upgraded.

Steady improvements in its customer segmentation capabilities and customer service focus has enabled the division to steadily eliminate potential disconnects between customer needs and the appropriate products and distribution channels, while continuing to simplify and streamline value propositions and cost structures.

These achievements allowed the division to capitalise on the excellent conditions for retail banking in South Africa in 2005, with healthy consumer fundamentals underpinning strong transactional and lending growth. The division was able to maintain high customer service levels despite significantly increased business volumes and compliance requirements.

Although the credit environment in South Africa remained benign, the division has continued to improve its credit systems and collections capabilities, in part through new technology. This has positioned it well to support the growth in targeted product categories, such as credit cards, as well as to deal with a more challenging credit environment expected to materialise in due course.

Given the increasing mismatch between retail asset growth and retail deposits, necessitating the utilisation of more expensive wholesale funding, the division has concentrated on improving its deposit gathering capabilities to ease margin contraction. Market share of deposits has increased to 27% from 24% in 2002.

A key focus area for the year was restructuring the branch network and head office to eliminate functional overlaps and raise employee productivity. Executive responsibilities were redefined to clarify lines of accountability and authority, and ensure the necessary strategic focus to continue driving growth in an increasingly competitive South African market.

In the rest of Africa, sustained disinflation and positive GDP growth trends were experienced although decreasing country treasury bill rates resulted in margin contraction, which was exacerbated by the low loan to deposit ratio characteristic of banking in most African countries.

Management invested considerable time and focus integrating country operations into the group structure. Management structures were streamlined and in-country finance and banking skills strengthened, and good progress was made upgrading systems and standardising processes.

The combination of better macro economic conditions and operational improvements underpinned good growth in fee and commission revenue.

Strategy

Growth opportunities through partnerships

Partnerships and alliances have become an important way to advance market penetration and customer acquisition as well as deal with disintermediation.

SA Home Loans, a residential mortgage-backed securitisation company that is 43% owned by Standard Bank, was the first non-bank mortgage lender in South Africa. Since inception in 1999, it has securitised five tranches of its debtors' book with a total value of around R10 billion. It has recently introduced a fixed rate 20-year mortgage product, and continues to improve its turnaround times and efficiencies.

In 2005, we partnered with Edcon, one of South Africa's leading retailers, to provide a pre-approved credit card to qualifying customers. Edcon currently has in excess of 3,8 million store-card customers, of which 68% do not have a bank credit card. This venture has provided a means to lower barriers of entry in this category and leverage popular brands to attract new customers. The joint venture has performed well, achieving sales of 300 000 cards and debtor balances of R500 million in four months.

To increase its involvement in the consumer finance sector, the division acquired an interest in RCS Investment Holdings from Foschini, another leading local retailer. RCS has a personal loans business and offers credit cards to merchants outside the Foschini Group. RCS has a five-year track record and a customer base of around 160 000. The RCS business will combine the best practice in the Foschini Group gained through many years of consumer lending in the South African middle market with Standard Bank's banking expertise. This will enable this business to explore new consumer lending possibilities and gain a bigger share of this important market.

Extending financial services reach

Extending the reach of financial services in South Africa is a key challenge, compounded by increasingly complex and costly regulatory obligations. In this environment, ongoing development is required to design and deliver simple, cost-effective products and services wanted by the emerging customer which constitutes an important component of our customer base.

Specific focus was given to growing our presence in un-banked and under-banked market segments in 2005. Since the introduction of the Standard Bank Mzansi Blue Account in October 2004, the bank has acquired in excess of 300 000 Mzansi clients representing a market share of 15% which, considering the Postbank's large presence in this product, is satisfactory.

During 2005, the bank announced a 1,3% price increase in fees on the Mzansi account, as well as a 3,1% increase in our transactional E Plan savings and investments accounts, which are targeted at low-income customers. Value-for-money pricing continues to be a priority.

In our constant drive to provide affordable products and services to all our customers, opportunities to establish lower-cost distribution channels beyond the branch network are provided by new technologies. Standard Bank's joint venture with mobile telephone operator MTN to offer MTN Banking was a first of its kind mobile banking solution. Its SIM card embedded banking functionality provides a new level of convenience, enabling accounts to be opened and activated telephonically within minutes. It is among the most widely accessible banking products in South Africa. Although uptake has been slower than anticipated, with appropriate education and marketing this product should provide a viable option for previously un-banked customers. With MTN's vast reach into Africa, we expect this partnership to create further opportunities for Standard Bank to increase its market share across the continent.

Shift in international strategy

Providing an important basis for our growth strategy in Personal & Business Banking are the banking commonalities that exist in developing countries. These include emerging classes of borrowers, under-serviced regions and a desire for reasonably priced and reliable banking services. We believe that the successes achieved – and lessons learned – in South African retail banking can be replicated in other emerging markets. This can be achieved on a modular basis, increasing the flexibility we have to create and unlock value in other emerging markets.

As such, our strategic approaches to achieving retail growth across the group's emerging markets footprint can be described as follows:

- **“Optimise to grow”** – applicable in markets defined by mature infrastructure and operational stability, such as South Africa. In these markets, our strategic focus is on retaining existing customers, growing market share, building volume in profitable segments, extracting efficiencies and optimising operations.
- **“Invest to grow”** – applicable in markets with potential upside for economic growth, such as Angola. These markets tend to be characterised by low Standard Bank penetration, non-integrated systems, and customer service and satisfaction that could be markedly improved. Alternatively, they are markets where we would like to be represented but there are no acquisition opportunities available. Here, it is necessary to establish infrastructure and drive organic growth to build market share.
- **“Acquire to grow”** – applicable in markets where Standard Bank is under-represented relative to the country's economic potential

and where there are attractive acquisition opportunities, such as Nigeria and Argentina. These are strategic markets for long-term growth, where South African expertise can add value.

Executive focus and resources have been allocated to accelerate this international growth strategy. The group's existing geographic footprint provides the basis for this growth plan, and growth in Personal & Business Banking will be leveraged off our existing and expanding Corporate & Investment Banking presence.

Financial performance

Personal & Business Banking generated 44% of the group's headline earnings, and grew earnings by 22% in 2005. The division achieved an ROE of 30,9% and reduced its cost-to-income ratio from 62,8% to 60,0% in 2005.

Operational performance

South Africa

Home loans

The division continued to benefit from the domestic housing boom, with property prices up 21% in 2005 on 2004 and substantial growth in industry-wide mortgage lending. Standard Bank grew its mortgage book by 32%, with registrations increasing 25%. Market share has declined marginally from 28,2% to 27,5%. This decline includes a R4,5 billion securitisation of our home loan book, which if adjusted for would increase market share to 28,2%. We are satisfied we have managed to maintain market share considering the higher levels of competition in this market both in terms of pricing and credit granting.

The average size of a home loan written in 2005 was R395 000 (2004: R350 000), the average loan-to-value ratio of the home loan book is 70% (2004: 69%) and the average instalment to income ratio is approximately 22% (2004: 20%). Non-performing loans as a percentage of book improved from 1,51% in 2004 to 1,21% in 2005 and the number of properties in possession decreased by 49% in 2005 illustrating the low levels of defaults experienced and improved credit control in this business.

Vehicle and asset finance

The vehicle and asset finance motor book grew by 29% against a 26% growth in industry sales of new vehicles. The non-motor book growth was 1% with market share decreasing from 36% to 33%. This was mainly as a result of lost share in the other goods category which includes unsecured personal loans that we account for in other lending rather than in vehicle and asset finance.

We believe we can improve our performance in this category and are investing in our sales force to drive this objective in the year

Operational review: Personal & Business Banking continued

Extending the reach of financial services in South Africa is a key challenge, compounded by increasingly complex and costly regulatory obligations, and pressing developmental issues.

ahead. Our sales team has been increased across all channels and in certain cases the division has re-entered the dealer market. These initiatives have begun to show good results. While turnaround times of finance applications have improved markedly, there is scope to reduce these further in 2006.

Card

The card business continued to perform well with significant improvements in earnings in this category. Cardholder spending increased by 30% and the lending book by 55%. For stores with StandardBank card terminals, credit card sales increased by 29%. This growth came primarily from first-time credit card holders rather than multiple cards being issued to existing holders. While bad debt ratios have increased, this was a planned feature of our accelerated growth strategy in this category. These ratios remain well within our internal targets and are better than international benchmarks.

Other lending

Balance growth of 21% in overdrafts, revolving credits and medium-term loans was due to a 16% increase in new customers,

a higher demand for credit, continued focus on cross-selling loans to our current account base and general process improvements.

Transaction and savings

The transactional business achieved strong year-on-year growth of 15% in the number of personal and business current accounts. Although the number of active E Plan accounts only grew by 5%, the balances on these accounts grew by 24%. This is important as it demonstrates a growing savings culture among low-income earners. The number of Maestro users increased by 33% with volumes increasing by 48%. Maestro is a simple card-based payment system that allows customers to make electronic payments directly from their accounts to retailers. The StandardBank cheque card achieved a 55% growth in the number of cards and the number of transactions increased by 69%.

Together with the growth in savings and investment deposit accounts, market share gains of approximately 2% were achieved in retail deposits.

ATMs experienced a 12% increase in the volume of transactions.

Loans and deposits by product

	Change %	2005 Rm	2004 Rm
Gross loans and advances	28	205 066	160 472
Instalment sale and finance leases	16	40 178	34 704
Mortgage lending	31	124 137	94 490
Card debtors	52	11 967	7 852
Transactional products	23	28 784	23 426
Credit impairments for performing and non-performing loans	17	(2 264)	(1 940)
Net loans and advances	28	202 802	158 532
Client deposit and current accounts	27	118 693	93 163
Current accounts	20	34 871	28 941
Cash management deposits	46	3 788	2 595
Call deposits	40	30 689	21 952
Savings accounts	22	14 085	11 544
Term deposits	(8)	22 699	24 583
Securitised funding		7 326	–
Other funding and loans	48	5 235	3 548
Interdivisional funding	28	70 287	55 093
Total	27	188 980	148 256

Rest of Africa

The 16 countries throughout the rest of Africa in which we operate have been ranked and prioritised according to the growth opportunities they offer and the most relevant strategic approach in each case has been determined. This has enabled the most appropriate management teams and capital structures to be put in place in each case.

The first phase of a comprehensive customer segmentation exercise has been completed, with further phases being continued in 2006. Significant system upgrades were carried out where necessary and systems across the continent are now more standardised. It is now possible to launch products simultaneously in all our African markets. The process of aligning our African operations to South African operating standards positively impacted service levels, with the independent Customer

Evaluation of Banks Survey showing a meaningful improvement from 8,42 (out of a total of 10) in 2004 to 8,97 in 2005.

Although it is reasonable to expect a three- to four-year timeframe before the full performance benefits of our strategic initiatives in Africa begin to flow through, the groundwork is done. It is pleasing that significant improvements in service levels have already been achieved and our various in-country product strategies have started to gain momentum.

Points of representation

	2005	2004
ATMs	4 151	3 603
Total points of representation	984	975

Focus areas for 2006

Going forward, Personal & Business Banking aims to balance between managing a mature business in a domestic market where growth in credit extension is expected to moderate, with potential growth opportunities outside South Africa.

In South Africa, specific focus areas will include:

- Reviewing, managing and reducing costs, closing revenue leakages and product gaps, and driving the profitability of direct channels through volume increases.
- Improving people management, with leadership support and branch management training targeted at further improving service levels.
- Driving our customer acquisition strategies through new and existing partnerships and existing channels within the bank.
- Continuing to drive deposit gathering to limit further margin erosion.

In the rest of Africa, focus areas will include:

- Continuing to apply the South African model of getting the basics of service and sales right.
- Streamlining the business banking segment by transferring the larger corporate clients to Corporate & Investment Banking and the small and medium corporate segment to Personal & Business Banking to improve service levels to these customers.
- Launching lending products (credit cards, home loans and vehicle and asset finance) into seven African countries.