Group chief executives' report

Sim Tshabalala / Ben Kruger

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Overview

Our repositioning of the Standard Bank Group as a leading financial services organisation in, for and across Africa is largely complete. We have realigned the allocation of our resources to our singular focus on Africa to ensure we stay relevant to our clients across the continent. This deliberate strategic response to the regulatory and market forces reshaping our industry is requiring significant investment in our systems, processes, people and culture, to create an organisation that stands to benefit from the long-term structural opportunities that sub-Saharan Africa offers, while also remaining competitive in the face of more immediate cyclical challenges.

1 359 cents
Headline earnings per share 27%
2014: 1 070 cents

15.3%
Return on equity (ROE)
2014: 12.9%

Our balance sheet is stronger and our group structure has been simplified. We have divested from international markets not aligned to our Africa strategy and redeployed our resources in carefully selected geographic markets, economic sectors, client segments and revenue streams that serve our strategic focus. We completed the disposal of a 60% controlling interest in Standard Bank Plc (SB Plc), our London-based global markets business, to ICBC on 1 February 2015, renamed ICBC Standard Bank (ICBCS), and finalised the sale of our banking subsidiary in Brazil in April 2015. We have retained our representation only in those global financial centres that support our strategy to facilitate growth and development in Africa.

Supporting the repositioning of the group is the front to back replacement of our core banking systems. These systems are transforming our relationships with clients by improving our service to them with more agile, flexible and cost-effective digital channels and mobile banking technology.

South Africa's GDP growth rate declined to 1.3% in 2015 as the economy suffered from lower commodity prices, reduced exports to China and the worst drought the country has experienced in over a century. This was compounded by internal socio-political factors and policy missteps. The sustained economic weakness has heightened the threat of increased unemployment and credit risk among personal and business customers. Growth in sub-Saharan Africa slowed during 2015, largely as a result of the impact of lower oil prices on the economies of Nigeria, Angola and Ghana, reduced demand from key trading partners and domestic political instability, as well as water and electricity shortages in some countries.

In 2015, headline earnings grew by 27% to R22 billion, driving ROE to 15.3% (2014: 12.9%), and pleasingly into our medium-term target range of between 15% and 18%. Our continuing operations in South Africa and the rest of Africa posted a solid performance, in spite of the deteriorating macroeconomic conditions across many of our markets. However, overall performance was negatively impacted by losses in ICBCS, in which the group retains a 40% interest that is equity accounted for in Corporate & Investment Banking's (CIB) financial results.

Strategy

Our vision is to be the leading financial services organisation in, for and across Africa, delivering exceptional client experiences and superior value. This sets the primary goals and standard of excellence we intend to achieve in the medium term, within the context of our multi-generational purpose which recognises that Africa is our home and we drive her growth. Our long-term success depends on this growth. As an integrated financial services organisation that serves the full spectrum of the financial needs of individuals, small and medium enterprises (SMEs), large corporations and governments across sub-Saharan Africa, it is in our interest that Africa's growth is strong and inclusive.

The intentions of our strategy place our clients at the centre of everything we do, which improves each client's experience and enables us to extend our advisory and financial products and services in a purposeful and responsible manner.

China and Africa have an important shared role in the future of the global economy and our partnership with ICBC combines their financial and global reach with our deep expertise in Africa for the benefit of our clients. Our seven-year collaboration with ICBC has been strengthened further by the framework agreement entered into between ICBC and Standard Bank in 2015, and remains an important element in our Africa strategy and in the future of ICBCS.

Becoming the leading financial services organisation in Africa

The ultimate test of our strategy is whether it will enable the group to deliver a superior ROE and sustainable growth in earnings over the medium to long term.

The South African franchise continues to provide a strong home base that produces the bulk of the capital we need to execute our strategy on the continent. Personal & Business Banking (PBB) South Africa has maintained a pattern of consistent growth in earnings over the past five years. This has been supported by our focus on improving the customer experience as well as our investment in technology, which has enabled us to build a strong digital infrastructure in response to changing customer needs. CIB has benefited considerably from the strong relationships it has developed with quality South African clients, and our capacity to support their growth ambitions beyond domestic borders. A number of the hallmark transactions done by CIB in 2015 were for South African corporates pursuing growth in sub-Saharan Africa.

The group's operations in the rest of Africa, which are embedded in the continent's long-term growth markets, continue to evolve and grow. However, the deterioration in commodity markets and our more cautious approach to client risk slowed the pace of growth in 2015. This is reflected in the banking franchise's overall growth in total income of 11% and headline earnings of 12%, compared to growth in 2014 of 22% and 41% respectively. The PBB franchise in the rest of Africa improved its financial performance, growing its headline earnings by 85% to R192 million in 2015 in a difficult operating environment. We now have seven countries on the new core banking platform after the first successful implementation of the Finacle core banking cloud solution during the year. In 2015, we focused on stabilising and improving the performance of information technology (IT) infrastructure, strengthening local management in some operations and improving risk management and compliance practices across the business. A representative office was opened in Ethiopia and we expanded our representative office in Côte d'Ivoire to a full service bank.

While financial markets in the rest of Africa are less developed than those in South Africa, they are demonstrating far higher growth potential in financial services as a result of governance reforms, higher economic growth, improving financial literacy and increasing product penetration. Over the medium to long term, we expect our banking franchise in the rest of Africa to continue increasing its contribution to group revenue and headline earnings, and to grow at a faster pace than our domestic operation which functions in a relatively mature market with constrained growth.

During 2014, Standard Bank Wealth (SBW) was established to align our non-banking financial services businesses across the group to create integrated financial solutions for our customers. During 2015, SBW strengthened its collaboration with PBB and CIB, enabling the group to compete more effectively through enhanced customer value propositions. SBW is being positioned to contribute to the group's future growth as it increases its share of wealth markets in South Africa and captures significant growth opportunities in the rest of Africa.

Our operations are resilient during negative economic cycles because they have diverse sources of revenue across the full range of financial services in different geographic locations, economic sectors, and business lines. For example, CIB benefits from the increased proportion of income it has gained in recent years from transactional products and services, which provide regular flows of business with lower capital requirements. Similarly, CIB's knowledge and experience in the main sectors underpinning Africa's growth and development in particular oil and gas, mining and minerals, and power and infrastructure, as well as across a range of other sectors such as financial services, telecommunications, retail and real estate, has mitigated declines in its oil and other commodity-related income. PBB is focusing on growing its market share in the higher value business banking segment to mitigate the impact of intense competition in its personal banking segments. SBW also has diverse sources of income and will enhance the quality of group headline earnings with the higher margin and lower capital nature of its income.

We allocate capital and human resources to market segments where we believe we will be most effective in creating value for our clients and generating profitable revenue. This is reflected in our strategy to shift the focus of our core transactional business in the rest of Africa to higher value individual and business customers. While this shift has improved the risk profile of our customer base in these segments, it has required patience as we balance the pursuit of market share in countries such as Nigeria, Angola and Kenya with the requirements of our risk appetite.

As these markets continue to grow and we build scale, we expect that our investments, particularly those we are making in digital infrastructure, will be more fully utilised by growing our customer base. An important contributor to this growth will be our increasing involvement in all elements of our business clients' value chains, where we provide a range of banking and non-banking financial services to the business owners, their clients and service providers, and their employees. Apart from the opportunity this offers to acquire new clients and deposits, it supports growth in non-interest revenue.

In an organisation as large as ours, employing 54 361 people across many jurisdictions, we face the risk that breaches of compliance and ethical lapses can occur, particularly where regulatory environments differ or are still evolving. We manage these challenges by instilling regulatory best practice across our operations, which includes interacting closely with regulators. Our group policies, which embrace international best practice, are binding on all of our subsidiaries. The group takes breaches of compliance very seriously and we respond decisively when they occur. One such example was the deferred prosecution agreement (DPA) entered into with the United Kingdom (UK) Serious Fraud Office (SFO) relating to a suspicious transaction that occurred in Stanbic Bank Tanzania in 2013. We self-reported the issue to the SFO within days of it coming to our attention and assisted the SFO in full in its investigations. While we deeply regret that this issue arose, we are confident that the group and its subsidiaries have responded appropriately, which has included providing additional training to our people. We remain committed to the highest business standards in all the markets in which we operate.

Transforming our IT infrastructure

We are entering the final stages of our IT transformation programme. We have achieved significant milestones in implementing our new core banking systems to support a digital environment which offers clients more choice, lower costs and easier mobility in an always-on, always-connected world. To date, we have transferred 11 million PBB customers onto the new core banking systems in South Africa and the rest of Africa.

The anti-money laundering programme was successfully launched in South Africa in February 2016. Our main objectives for the remainder of 2016 and 2017 will be to transfer the balance of 6,3 million savings, investment, complex personal and business customers onto the new platform, and discontinue legacy systems which are currently operating in parallel with the new infrastructure. With the support of continuous technological advances, we now offer our customers simpler and more efficient payment and banking products through integrated channels, including mobile banking. As we conclude the implementation of the major IT programmes, our highest priority will be to ensure the stability and availability of our systems. We will continue to focus on improving cost efficiencies to bring IT expenditure within global benchmarks by 2017.

Our greatest competitive advantage

We have continued to deepen our people's understanding of the group's strategy and the culture of clear accountability, effective decision-making and social relevance that is required to support its effective execution. We work in a fast-paced, highly competitive industry with ever-changing demands on our people as we build a digital organisation. Therefore it is necessary to help them adapt by equipping them with new skills and remodelling processes, to enable them to fulfil the needs of our clients and provide exceptional client experiences.

We recognise that employee engagement is a lead indicator of client experience. We are committed to best practice people management and to a workplace where high performance is expected and rewarded. Diversity in our leadership teams and demographic representation among our employees across Africa is an advantage as we serve equally diverse client bases. As we make the transition to a more integrated African business, we regularly relocate staff between our domestic and rest of Africa franchises, although we are mindful of the need to balance local requirements against this strategic objective.

This year Simon Ridley retires as our chief financial officer and group financial director. Simon embodies what the people of Standard Bank aspire to be. He is highly respected across the group and the industry for his unshakable integrity, his razor-sharp intelligence, his quiet eloquence, and his immense banking and accounting skill.

Simon is a great manager as well as a great accountant and banker. He has always found exactly the right balance between expecting the best possible work from everyone, including himself, while simultaneously being supportive and approachable. He has been a consistent advocate of transformation, and has created a finance team that embodies excellence and diversity at every level. Over his long and distinguished career with us, he has made an immeasurable contribution to the profitability and sustainability of our group. He will be greatly missed on our board and executive committee, but we are pleased that we will continue to benefit from his wisdom and expertise on the boards of several of our group companies.

Prospects

Global growth is projected by the IMF to accelerate to 3.4% in 2016 and 3.6% in 2017, although the recovery in global activity is projected to be more gradual than previously anticipated, especially in developing economies. In advanced economies, a modest and uneven recovery is expected to continue. Risks to the global outlook remain tilted to the downside influenced strongly by a broad-based slowdown in emerging market economies, China's rebalancing to a consumer and services driven economy, lower commodity prices, and the gradual exit from accommodative monetary conditions in the United States (US).

Most countries in sub-Saharan Africa are expected to experience a gradual upturn in economic growth, but at lower rates than those seen over the past decade. This reflects the adjustment to lower commodity prices and higher borrowing costs, which are affecting some of the region's largest economies, as well as a number of smaller commodity exporters. In South Africa, the growth outlook for 2016 has slipped to below 1% due mainly to the effect of the drought and tighter financial conditions.

The year ahead is likely to present a demanding operating environment in which consumers and businesses will have to adapt to higher interest rates and the full effect of currency weakness. However, the group's strategic positioning, well-capitalised and liquid balance sheet, and committed employees will enable us to withstand the macroeconomic uncertainties and volatile markets for the sustained benefit of our clients. Our medium-term ROE target of between 15% and 18% remains intact. The group's ROE performance will however be affected by factors such as economic growth in South Africa and the rest of Africa, and the retention of an investment grade sovereign credit rating in our domestic market. As such, we are working closely with the authorities to promote a stable, growth-friendly environment.