THE NATIONAL BANK OF AUSTRALASIA - RECENT DEVELOPMENTS

By T.B.C. Bell, General Manager, Melbourne

(This address was given by Mr. Bell to the Victorian Branch of the Society in Melbourne on 18 June, 1973. It was foreshadowed by, and complements, the review of the Australian Banking Industry published in JASSA of September 1973.)

I believe that it is some seven years since a representative of a trading bank appeared before you in the role of guest speaker, and I am a little intrigued as to the reason for this under-exposure. Maybe it was because there were so many other industries and companies meriting your attention or perhaps it was a result of some shyness on our part to submit ourselves to your microscope. If the latter, let me say that I can well understand the coyness of my banking confreres, because unquestionably there is a vast contrast between the sphere of responsibility of a trading bank and that of almost any other public company, and also, I suggest, a group which can produce such an excellent background paper as you have done hardly needs a guest speaker to elaborate upon it.

However, I appreciate the opportunity to be with you tonight. This excellent background material has removed any necessity to go into too much detail, but unfortunately I have been outside Australia recently and did not have the time to fully comment on your material before it had to be printed. There are some minor aspects where I might disagree and some which require some explanation. I hope to do that during this talk.

The Banks Have Wide Responsibilities

All public companies have, of course, a responsibility to the community, but I think you will agree that the primary responsibility of an industrial or merchandising company is to its shareholders, and that optimisation of long-term profitability is its main objective. This observation certainly applies also to the trading banks, but, because they occupy a privileged position in the community, inasmuch as they are one of the few groups permitted to create credit, they shoulder additional heavy responsibilities, must adopt different priorities, and of course accept greater control by the appropriate authorities.

The operating philosophy of my own bank recognises the over-riding influence of our national role as a responsible corporate citizen. For example, we accept as part of our national responsibility the obligation of maintaining loss-making branches when there is no suitable alternative from the viewpoint of the convenience of our customers. For very many years banks have accepted and applied Government policy regarding rural producers and exporters and have granted concessional interest rates at material cost to themselves.

Firstly, I want to emphasise the overriding responsibility of a bank to its depositors. Collectively, the trading and savings banks hold some sixteen and a half thousand million dollars of the public's money - the National Bank Group itself currently has liabilities to the public exceeding three thousand million dollars - which you will agree is a tremendous trusteeship.

The protection of these liabilities is obviously of primary importance to us and to permit any short-term fluctuations in the value of our assets to affect the confidence of the public in the National Bank would be a grave disservice to these depositors, to the banking system, to the bank and its shareholders and to the national interest.

Another aspect of national responsibility is the provision of banking facilities over the vast geographical spread of Australia. The National has 970 points of representation here and, as you know, a number of these are in relatively small and isolated centres involving not only additional staffing costs but an expense in communication disproportionate to the revenue earned.

Associated with this is the need to provide an efficient and reliable money transfer system throughout Australia and also internationally. By this I mean not only the provision of cash (i.e. Notes and Coin) where it is required and when it is required but also the credit transfer and cheque clearing system. The burden of the cash movements and the mountain of paper which has to be moved daily is by no means understood even by those large customers who cause the main burden. The statistics of debits to the clients' accounts of Australian banks give some indication of this volume, and in February this year aggregated $M28,937, and as an indication of the growing volume this total is 34% higher than the same month a year ago.

As banks credit their customers' accounts with cheques as they are deposited, obviously the speed with which they deal with them has a material effect upon profitability.

The "float", as we call this great volume of uncleared cheques etc., requires constant control. My own bank has just completed a major attack, Australia wide, on this problem which we estimate brought benefits exceeding the $300,000 per annum mark. By benefits I mean of course that we reduced the cost of providing this service by that amount.

Another major responsibility lies in the field of national monetary policy and is the reason why banks are controlled and licensed under a special Commonwealth Act of Parliament, rather than under the State Companies Acts and why they are exempted from many of the requirements of accounting and reporting that the Companies Acts impose on other public companies. I would admit that the figures of banks, quite unlike those of the modern miss, conceal almost as much as they reveal, and - carrying this analogy a little further - I could agree that the time may not be far off when our published accounts will divulge more information than is presently the case.

I don't think it is any secret that the major trading banks have put some work into examining their accounting procedures in anticipation of the possibility of greater disclosure. Those of you who watch these things closely would have seen signs that some banks have amended these procedures already in some respects. For example, in our case we have adopted and announced a policy of amortisation of fixed interest investments and now charge a provision for possible bad debts directly against profits.

Tonight, however, I do not propose to be party to any "strip tease" act, nor, in fact, do I wish to be drawn into any technical aspects of bank accounts. I would be a disappointment in both. I propose to direct my remarks to broader aspects, leading, I hope, to a better understanding of the problems and prospects of our industry.

Banking Since World War II

I feel that to understand the present position of the trading banks - and, of course, the National Bank - I need to briefly take you back over developments in the post-Word War II period. That period has been characterised by a series of strong inflationary pressures to which (until quite recent years) the classical antidote was the adoption of a policy of credit restriction, which because of doubts as to Federal powers meant that only the banks were directly affected. Consequently more drastic restriction on bank credit was necessary to counteract the activities of the "fringe bankers" which built up outside Federal jurisdiction. As a consequence, there was an outcrop of strong groups of financial organisations which, while not banks within the accepted meaning, were in fact able to provide funds which in many respects were alternative to those normally obtained from trading banks.

The Pressures on Bank Profits

As some illustration of this point, an assessment of the total assets of financial institutions showed that in 1953 the banks held 58.4% of the total but by 1970 this ratio had been reduced to 44%. Meanwhile, assets of groups, such as instalment credit, rose from 2% to 9.6% of the total and building societies from 2.8% to 5.2%. These figures are from Professor Arndt's textbook, and I do not have any later figures, but believe the abundance of merchant banks in various forms and the great expansion of the building societies since 1970, would have further diminished the bank percentage. That is, until very recently.

A further consequence of the series of credit restrictions was the growth of inter-company loans, arranged through brokers or merchant bankers or sometimes directly between company treasurers when companies had compensating cash flow cycles. As a result of the growth of this inter-company market and a growing trend by Australians to make every dollar earn its keep, the current deposits of the trading banks (i.e. those not earning interest) decreased in relation to interest bearing deposits. For instance, in 1952/53 less than 20% of total trading bank deposits carried interest, but by 1971/72 over half the deposits were interest bearing.

The increasing sophistication of corporate Treasurers has inevitably resulted in less money being left in credit balances and in the increasing use of overdraft limits as 'last resort' or buffer facilities to their money market or intercompany market operations.

The Banks' reaction has been the costing of these larger corporate accounts and the introduction of new fees e.g. the unused limit fee. Quite obviously the banks have to retain in reasonably free form the liquidity judged to be necessary to back up unused overdraft limits. This is costly. To some extent then these corporate treasurers have brought upon themselves costing processes which in many cases are being applied quite objectively by their bankers.

Since what we may call the basic "trading" profit of a bank arises from the difference between interest received from advances, investments and the like, and interest paid on deposits, this growth of interest-bearing deposits - this change in the deposit mix - constituted an important depressive effect on bank earnings.

This increasing percentage of our deposits is held for fixed terms up to four years which has encouraged banks to increase the volume of lending approved for medium terms and this, together with the introduction, by arrangement with the Reserve Bank, of Farm Development Loans and Term Loans, has done something to compensate for the increasing average cost of money.

Of course this increase in both the volume and percentage of term deposits is beneficial to profits in times of rising interest rates in the banking system because of the "lag" but of course has the reverse effect when interest rates are falling.

Banking is Labour Intensive

Banking, as you know, is a labour-intensive industry, and therefore has been more affected than many other sections of industry by the steep rise in salary and wages costs, particularly in the past three or four years, which has seen the average male salary increase by 9.8% per annum. Today, no less than 80% of our total operating expenses relate to salaries and wages. That, of course, reflects the labour-intensive nature of the service industry we conduct and you will understand that with a growing population and an expanding industrial and business structure, it is essential that we keep abreast of demand for our services. I made a brief reference earlier to the fact that we - the National - now conduct some 735 branches plus an additional 235 agencies. You will appreciate that such a branch network involves not only substantial capital outlay, but, in addition, we must be prepared to accept at best a low rate of return from many of our more recently opened branches pending their development. Overall, of course, it should promise future sound and profitable expansion of the bank and it is, in fact, a case of balancing growth against profitability.

You will appreciate, also, that the operation of our branch structure involves regular research and costing. Whilst the figure which I have given you - 970, for our total openings - is only about 20 more than five years ago, it has not been a matter of just sitting down and awaiting results. There has been a quite substantial opening of new branches as opportunity occurred and the importance of areas developed, whilst, on the other hand, a number of established branches have been closed on the grounds of non-justification of their continuance. If we talk in terms of branch turnover since 1968, this represents a movement of some 90 branches.

Positive Actions Have Been Necessary

These few facts will indicate that there have been very strong pressures on "true" banking profits, and the fact that the banks in Australia have nevertheless been able to show continuing growth in their earnings per share indicates, I submit, that they have over the years taken positive measures to offset the adverse trend. Amongst the earlier measures taken were to make substantial investment in the instalment credit industry and to establish a savings bank paralleling the trading bank's operations. The National Bank was the leader of the first movement and I confess rather late in the second. In addition, all the banks have actively expanded their travel departments and several have moved into such areas as portfolio managers, investment nominees, managers of unit trusts, and the like.

The rapid expansion of Australian overseas trade has provided a further opportunity to banks to maintain profitability. In some cases new overseas offices have been established, in other cases links have been established with international banks to provide a maximum service to our customers.

In essence, I think I might summarise the position by saying that the problems which developed regarding "true" banking profits were overcome by the widening of the bank's services and by diversifying horizontally into what has been called "fringe banking".

Cooperative Activities

Some years ago there was a sustained joint television publicity campaign using the theme of "Competition between Banks". While this competition has certainly been maintained right up to the present time and each bank is now actively extolling its own virtues, we have also shown in the last ten years ability and willingness to act cooperatively when either the national interest or the magnitude of the transactions called for united effort.

An early cooperative activity was Australian Banks' Export Refinance Corporation Ltd., which was formed in 1964 to assist the trading banks in meeting the requirements of exporters, particularly those extending medium and longer term credits to their overseas buyers. This company has steadily expanded the magnitude of its operations and at the last accounts in June 1972 had loans outstanding of $33.6 million, compared with $21 million a year earlier.

As a refinance corporation for its own shareholders it requires no staff to speak of and little overhead. It has proved a very worthwhile addition to bank facilities in Australia.

In September 1967 Australian Resources Development Bank was formed, with the objective of accelerating economic development and facilitating greater Australian participation in the development and use of its resources. This Bank has provided both equity capital and loan capital and various combinations of the two. At September of last year it had loans and commitments exceeding four hundred million dollars, apart from its shareholdings and other assets arising from its operations. It too provides refinance facilities for its shareholders but also engages in direct lending on its own behalf.

Both these companies have rendered outstanding services to the Australian economy and have, while rendering these services, operated with increasing profitability to the extent that a 20% dividend was paid by the Resources Development Bank and a 7% dividend by the Export Refinance Corporation last year to the participating banks.

Wide Activities Of National

Turning more specifically now to my own Bank - National Bank - there is no need for me to recount in detail the various activities which we conduct. Like most of our competitors, our philosophy is to provide a full range of financial services in such form and variety that every financial requirement of our clients can be satisfactorily handled by the Bank or its close associates.

You will also be interested in the major operation which we are now completing - the acquisition of the balance of ordinary and preference shareholdings in Custom Credit.

Custom Credit Story

It may well be felt by some of you that the Bank may have shown some lack of consistency in moving, in the first instance, to a 40% investment, then to a partly-owned subsidiary, and now towards total ownership.

As I indicated earlier, at the time we first took our interest in Custom Credit in 1953, there were fairly sharp lines of distinction between instalment credit and trading bank activities, and our holding in the Corporation therefore, at that juncture, represented an interesting investment in an area which was associated, but not closely associated, with the Bank's own activities. The effect of the successive credit restrictions of the 50's and 60's was to greatly expand the opportunities available to the instalment credit companies, and Custom Credit was certainly not behind its competitors in taking advantage of the business offering during that period.

Subsequently, when, in company with so many of the finance companies, Custom Credit showed some signs of indigestion in the early 1960's, the Bank stood solidly behind its investment, agreed to a substantial reduction in dividend distribution from 15% down to 10%, and fostered the building up of internal strength in the Corporation.

Reasons for the 1970 Acquisition

The subsequent expansion and greatly increased profitability of Custom Credit, in which the Bank has shared, may be regarded as some reward for the Bank's earlier sacrifice of income as well as justification for the continued confidence we have had in its management. Our action in 1970, in acquiring from public shareholders a further 20% of the Custom Credit ordinaries, partly reflected the closer relationship established during the earlier and more difficult years and also ensured that Custom Credit was not vulnerable to the then current wave of invasion into Australian credit companies by overseas banks. We were determined that, so far as it lay in our power, Custom Credit would remain wholly Australian owned and believed that the most effective safeguard was to make Custom Credit a subsidiary of the Bank.

Why 100% Custom Credit?

Events moved quite rapidly after 1971 in our relations with Custom Credit. The closer link that resulted from the acquisition of the additional shares contributed to the continuing growth of Custom Credit's activities and profitability, while changes in Reserve Bank control of the trading banks' operations commenced to have an influence on the relationship.

We, as a trading bank, were enabled by the Reserve Bank to operate in the areas of personal loans, leasing arrangements and other activities which previously had been largely confined to the finance companies and, at the same time, we were given some latitude in the fixing of interest rates for larger transactions. Also, there was a continuing trend for finance companies to move from retail hire purchase contracts over to mortgages and commercial loans, leasing, personal loans and the like. In 1964 over 53% of the outstandings of finance companies were in the instalment credit area, but by 1973 these hire purchase operations were down to less than 31%, while mortgages, commercial loans and leasing represented some 58% of total activity.

With the greater freedom afforded the banks, and the change of policy of finance companies, it became obvious that we would be moving into greater competition with our own subsidiary. At the same time the whole spectrum was confused by the announcedintention of the Commonwealth Government to bring the finance industry and other fringe banking operations within the control of the Reserve Bank.

You will appreciate that, in these circumstances, some conflict of interest was almost certain to arise between the departments of the Bank on the one hand and Custom Credit on the other, and as these conflicts could lead to hesitancy on the part of both Bank and Custom Credit, the line of profitability and the line of shareholders' interests seemed to point quite clearly to the need for a single shareholding in the parent company.

In addition, it had become clear that the part the Bank could play in building up CCC including National and General Insurance was much greater as a 60% than as a 40% shareholder, and we felt that these benefits arising from closer association would be further increased if we were fully united.

Therefore, my Board made the offer to acquire the remaining ordinary shares of Custom Credit by share exchange and this operation has now reached a stage that we have received acceptances for well in excess of 90% of both the ordinary and preference shares to which the offer applied, and we are now taking the necessary actions to acquire the remainder.

No Integration Intended

Notwithstanding this action and the growing areas of common interest, it is not the intention of the Bank to undertake any increased integration of Custom Credit and ourselves at operative levels. In the past, each company has contributed substantially to the success of the other, we in the Bank having been of considerable assistance to Custom Credit in the raising of debenture funds and in our contribution to the credit rating of the company, as well as through the services of our branches, while Custom Credit has made its visible and appreciated contribution to the total profits of the NBA. There are, of course, frequent policy discussions between the companies, but there is no interference in day to day management.

Each company still operates its own Head Office as well as State and Regional offices and will continue to do so. Staff are separately recruited and operate under their own conditions of employment; it is our joint feeling that the training that produces a good bank officer would not necessarily produce the type of staff which Custom Credit requires, nor would the converse be true. No doubt, the future will find us increasing our mutual services, but I do not see any change being made in the independent nature of our operations.

I have dealt for some minutes on the Custom Credit situation - I believe properly so - since it now amounts to a very substantial part of our activity but I will now turn to some other facets of our organisation.

The Property Company

Some years ago we established "NBA Properties Limited" - a company which has moved into the public eye with its recent raising of some $10 million of debenture capital from the investing public.

The Bank has always had substantial holdings of real estate but with the increasing development of the business centre of our capital cities larger and taller buildings are necessary both because of economic factors involved and also to maintain our banking image in the community. This trend to larger size means that we must become landlords to an increasing degree for commercial space and maybe for retailing space as well.

Last year - through the Property Company - we opened our new South Australian headquarters in King William Street and two major branch reconstruction projects will also commence shortly in that Stage.

Most of you will have seen the Property Company's recent operation - our Stock Exchange branch in Queen Street - which opened in May of this year. Currently a substantial construction is under way in Hunter Street, Sydney. Additionally we have acquired properties adjacent to our principal office in George Street with the object of an early re-development of the combined site area for a new State Office and retail complex.

In Queensland too we have purchased properties which will be reconstructed to house our growing major banch business in George Street, Brisbane. In Queen Street we have outgrown our present State Office at the corner of Creek Street and are actively seeking additional sites on which to build in a manner befitting the importance we have placed on our widespread and valuable banking representation in Queensland.

We have centralised our Victorian computer operations in a special building in East Melbourne. The Property Company has acquired areas adjoining our present Head Office building and has some 62,000 square feet with substantial frontages in Collins Street, Elizabeth Street and Flinders Lane available for our new Head Office complex, and we are preparing to minimise the inconveniences that must occur when we rebuild our offices on this site.

The use of a separate subsidiary enables us to divorce these property operations to some degree from banking, and I know you will all agree that some use of loan funds for these new constructions is a desirable gearing to assist the overall profitability of the group.

International Expansion

Turning now to the international field, you will all be aware that Australia's international trade has expanded in the last two or three years to levels which we never dreamed of in the 1960's. We have tried to keep to the forefront in the provision of services for our exporters and importers and have substantially expanded our International Department - the more visible actions being the establishment of a number of representative offices overseas. Whereas in 1968 our only overseas offices were in the United Kingdom, we have now representatives in Japan, Singapore, New York, and Jakarta, and a branch in the New Hebrides, and further offices will be opened as our trade develops.

Last Thursday it was announced that this Bank would take an equity interest in a new company, P.T. Indonesian Investments International, in which we will join a leading Indonesian bank, Bank Dagang Negara, First Chicago Limited, and two Japanese partners, Mitsubishi Bank Ltd. and Nikko Securities Co. Ltd.

Chase N.B.A.

I should also make reference at this stage to our associated Chase N.B.A. Group Ltd. which has continued to expand profitably and during the last 12 months I am happy to tell you we have received our first dividends from this investment. Chase N.B.A., we believe, fills a much needed gap in the middle term loan area and its facilities are being increasingly used by Australian companies. In addition the operations of the Chase N.B.A. Group have now been extended to New Zealand.

Also associated with the Chase N.B.A. Group is "All-States Commercial Bills Ltd.", a bill discounting company with a record of growing success. Unfortunately, by a Reserve Bank ruling we have been limited to a 10% holding in this company, although we have a one-third interest in Chase N.B.A.

Credit Cards

Quite an amount of publicity has been given to the cooperative charge card plan which the banks will be introducing in mid-1974 in Sydney, Melbourne and Canberra and we have already formed the servicing company, Charge Card Services Ltd., and commenced the construction of the headquarters.

The plan is that each card-holder will deal direct with his own bank, and therefore the normal banker/customer relationship will apply. The operation will be serviced by a new sophisticated computer installation and the banks will have on line access to this facility, thus minimising the risk of fraud which caused some bitter experiences with credit cards in other countries.

While we are not expecting any dramatic developments in this area, it will represent a further service to our clients and we will be maintaining pace with overseas developments in many transfer systems.

The Current Year

Turning now to the events of the current year, on 17th May the National Bank released its half-yearly result and for the first time included a comparison with the previous equivalent period showing a rise of 41% on consolidated profit figures. The conditions which led to this record result are well set out in the background paper under the heading "Ideal Conditions for Strong Profit Growth", but in our report we highlighted two of these activities, namely, "Revenues from the greatly increased lending and investment", and also "International operations showed a sharp uplift in response to the abnormally large capital inflow and outflow".

We would be optimistic to expect a duplication of the trends of the first half of the year in the second half, as we have had to meet a 1% call to S.R.D. which comes from our funds otherwise available for advances or investment, while overseas currency movements are not likely to be as high because of the Government's action against capital inflow.

As I mentioned earlier, we hope to have the whole of the Custom Credit shareholdings well before the end of September, and should therefore be able to consolidate a larger proportion of the profits of Custom Credit in the second half of the year. On the other side, of course, we will be issuing some 13.8 million shares to the Custom Credit shareholders, so that at the end of the year our capital will exceed $57 million.

A number of you have already made your forecasts of the Bank's full profit for the year and have made calculations which indicate that Custom Credit could contribute about half of our total profit after tax for the full year.

As stated in our interim report, we are looking forward to a record year for the Bank and its subsidiaries, and despite the large increase in the capital we could maintain the earning rate per share which we achieved last year. If this is so, we may take some satisfaction from the fact that since we commenced the acquisition of the additional 60% of the Custom Credit shareholding we have been able to substantially increase the earnings per share of the Bank, despite the fact that the issued capital will be more than doubled.

During this three-year period, there have also been substantial benefits to the shareholders both of the Bank and of Custom Credit, and this achievement is a practical demonstration of the vitality of both companies, and also a challenge for us to maintain this type of growth.

The Future

Finally, looking to the future, I think banks have demonstrated their ability to adapt to the changing financial requirements of the Australian scene and to conduct our affairs not only to increase the scope of our activities, but also to give satisfaction to our customers and shareholders. I am confident that we can continue in the future to be flexible and efficient and should therefore still be capable of producing results which will keep banking among the growth industries. In making this speculation, I would not want to under-estimate our problems.

An unresolved area is the extent to which additional financial operations will be brought under Reserve Bank control. While the new Government has stated its intention of extending Reserve Bank controls to the fringe bankers, there has not yet been any positive action in this direction and the recent actions by the Reserve Bank were a continuation of the previous method of using the trading banks as the principal means of regulating the whole financial structure in Australia.

I hope this remains so as I believe that any increased restraints imposed upon the banking system could well be greater but almost certainly would last longer if they were also imposed upon the "fringe" than they would if imposed upon the banks alone. Given the option I would prefer the greater freedom which the Reserve Bank's recent market oriented approach permits than the across the board controls the Government seems to favour.

So far as the future prospects of my bank are concerned the Board has already announced that profit from banking for the year to September is expected to be a record. To this will be added 100% of CCC's profit for four or five months.

However, 1974 is most difficult to forecast but again, so far as my bank is concerned, September 1974 will be the first occasion on which consolidated profit will benefit from the whole of CCC's profit for a full year.

Whether this will suffice to allow us to show another increase in consolidated profit depends on what direct the Government's expected anti-inflation moves take and the effect of that upon those profit determinants mentioned in your working paper.

The group is now stronger than ever - more diversified (although still in the type of business it understands) and is demonstrating increading flexibility. These are all, surely, grounds for some optimism.

-oOo-

SOME ASPECTS OF THE SHORT TERM MONEY MARKET IN AUSTRALIA

(An address delivered by Mr. L. Wilkin to the Queensland Branch of the Society on 26 September, 1973.)

1. INTRODUCTION

The short term money market in Australia can be divided into two broad sectors, the official and the unofficial markets.

1.1 Official

The official market consists of 9 dealers, the main characteristic of which being that they have the right to borrow "lender of last resort" funds from the Reserve Bank. In return for this security, the dealers are subject to controls placed on them by the Reserve Bank.

1.2 Unofficial

The unofficial market at the present time consists of possibly about 100 organisations which are involved in different capacities. The unofficial market could be further divided into

- the buy-back market
- the intercompany market
- the commercial bill market.

However, it is difficult to see a complete distinction between the official and unofficial markets, as there is dual membership by most official dealers as well as a strong interrelationship between the securities provided. It is generally estimated that if that estimate is correct, then at present (September 1973) somewhere between $1,500 million to $1,600 million would be deposited on the money markets.

In describing how a money market dealer functions, I will use the official market as the example. Time only permits a very sketchy outline.