AUSTRALIAN BANK AND BANKING IN THE 1980'S

An Address by

W.P. GURRY

Executive Director, Australian Bank Limited
to The Securities Institute of Australia, Victorian Division, Melbourne, July 23, 1981.

Introduction

I am very pleased to be here talking to you about Australian Bank, the role its Directors and management hope it will play in the Australian financial scene, and about the Banking scene in the 1980's. This is probably the best time for me to talk because we are still in the honeymoon period. We have not yet had to hunt for business, or, worst of all, refuse anyone a loan. In this honeymoon period it looks as if we have jumped from being the sixth largest privately owned Australian trading bank to the fourth. If we can make this kind of progress before we open our doors, we may actually prefer to keep them closed.

Before talking about what we hope Australian Bank will do, let me make a few comments about the origins of the Bank. They lie very directly with our Chairman, Garrick Agnew. Like, I expect, some of you and me, Garrick had frustrations with the banking system and had been particularly disturbed by the apparent lack of interest shown by many bankers in supporting growing businesses. This experience indicated that there was a considerable need in the business community for financial institutions which might specialise in providing finance in the medium business sector, and which would be equipped in their human and analytical skills to understand the requirements of this sector.

Garrick saw the established banks as institutions with a privileged position, which were not meeting some of the requirements of the market or maximising their opportunities. This view was supported by other objective evidence, such as the rapid growth of the merchant banks, credit unions and building societies in the last decade which indicated that there were many market requirements not being covered by the banks.

Some four years ago Garrick was suggesting that the banking system was far from perfect to another West Australian, John Stone, Secretary of the Treasury, and, perhaps to gag the debate, Stone suggested that if Garrick thought the Australian banks were so uncompetitive, he should start one.

The story of how we went from there to here is a fairly long one, and many parts of it are not of general interest. However, I think it is fair to say that in general we have met with a most receptive climate. After Garrick and Mark Johnson had convinced Treasury and Reserve Bank officials that they were serious, they supported our efforts all the way through. We have, we think, obtained first rate shareholders and, as best I can judge, we enjoy a considerable degree of support from the community. Now we shall have to see how it performs in practice and so I should perhaps spend some time on the general objectives of the bank, dealing specifically with its possible role in the banking scene in the 1980's.

General Objectives

Many of the problems with the banking industry stem from its structure. The industry consists of a small number of very large organisations with large hierarchies and slow decision making processes. These organisations are primarily there to provide a range of financial products – cheque accounts, overdrafts, bill lines and so on. If these products do not fit the customer's requirement, the customer has to go elsewhere. The ability of the traditional bank manager to advise a corporate customer as to the best methods of financing his business seems to have declined as business has grown more complex.

We see the new bank filling the niche which the existing banks do not cover adequately. The new bank will be small, so that its lines of communication and decision making are short, allowing it to respond rapidly to customer requirements. (We see it as being small also for reasons of building a high level of expertise.) The approach we want to develop is problem solving for a customer – i.e. trying to design the best method of meeting his financial requirements – whether the funding ultimately comes from the bank itself or from some other source which is either cheaper or offers better conditions. In short, we want a bank which has a service orientation and which will provide that service with a high degree of professional competence and skill.

As a new organisation, the Australian Bank cannot be all things to all prospective customers. It will limit the kinds of customers it deals with, as it develops the skills and abilities to service these customers. For example, very large companies have financial skills in depth. They can analyse and solve many of their own problems and then tell the bankers or other members of the financial community just what they want. Smaller companies often do not have this depth. They know they have a requirement but they do not necessarily know how that requirement can best be filled. It is in this area of problem solving, combined with the provision of finance, that we see a great market opportunity.

If you accept this line of reasoning, you will also understand that we see the new bank as being, in many ways, complementary to the existing banking system, rather than being in direct competition with it. I think it is important for me to make clear that we see Australian Bank as seeking a second bank relationship with its customers and we in no way wish to disturb their other existing arrangements. If these arrangements have been satisfactory, there is no reason why they should not continue to be so; we think the new bank may be able to add additional resources, made up both of advice and expertise in market conditions and in providing additional funds from its own balance sheet.

With this specialised approach, we think we can also avoid a looming problem area for the established banks, and that is, their large branch network. This branch network is becoming increasingly costly to maintain, as real estate values go up and staff become more expensive to employ. At the same time, technology is developing rapidly, which means that fewer and fewer people require easy access to a branch bank. Salaries are paid directly into bank or building society accounts, and cash is available from automatic tellers which operate round the clock. Purchases are made with credit cards, and a few cheques are written to cover monthly accounts. The technology is now available to allow you to use push button telephones to pay your bills, so the cheque is well on the way to redundancy. We see the large banks having to confront these problems, arising from their historic development, while we can concentrate on getting on with the business we want to do. The recent merger activity is, I suspect, partly motivated by banks confronting this problem and moving towards rationalisation of their branch networks . . . rather than an over-reaction to the imminent start up of Australian Bank!

With this preface on our general objectives, let me turn now to the specific strategy of Australian Bank outlining the basic concepts on which it is constructed, the market segments on which it will focus and the activities in which it will engage. For the time being, at least, I will have to leave it to your own imaginations to put our strategy into pragmatic terms. I hope you will understand my omission of certain details – we think our future success might be helped by at least some elements of strategic surprise.

Strategy

There are four basic concepts in which the strategy of the Australian Bank is constructed. These cornerstones are:-

1. Customer orientation;
2. Professional excellence;
3. Product/Market segmentation; and
4. Competitive advantage.

Customer Orientation

Any entrepreneur can tell you that the one truly indispensible ingredient for a successful business is a customer. Some businesses manage to succeed without adequate finance, without expert management, some even without a distinguishable product or service; but no business can succeed without customers.

It is our belief that some of today's financial institutions have lost sight of the fact that their real reason for being is to serve the needs of their customers. We do not intend for this to happen at Australian Bank and have oriented virtually every aspect of our bank – our strategy, our organisation structure, our systems and our staff – to revolve around the customer.

To put the essence of our strategy into a single phrase, it is "to provide value to customers through quality service". We are not in business simply to make big profits or to build a big balance sheet. These things will happen if we can provide greater value to our customers than our competition. Looking at a banking relationship, from a customer's perspective, there can be many ways to improve the value to the customer. Paying a higher yield on his deposits or charging a lower rate on his loans may be the obvious, but these opportunities are severely limited by the prevailing market conditions for the most common of all commodities – money. Rather, the real scope for improving value to the customer lies in providing professional service tailored to his needs: for example, greater access to funds for credit worthy customers too small to get attention from the giant banks, faster decisions for people in a hurry, greater creativity and flexibility in designing solutions for customer's financial problems.

Australian Bank intends to offer services to individuals, professional firms and partnerships, corporations, institutions, Governments and Governmental bodies. A variety of chequing account, interest bearing term deposits, and loan facilities will be provided to individuals and professional firms and partnerships.

For individuals we hope to offer a service which will be fully integrated as a total banking relationship.

For professional firms and partnerships, in particular, legal, accounting, brokerage, medical and other such organisations, Australian Bank intends to offer a special capability to service their financial and advisory requirements tailoring a variety of services to meet both the commercial banking needs of the firm and the personal needs of its principals.

Australian Bank also seeks to develop substantive, long term relationships with corporate and institutional clients. We will concentrate on developing second bank relationships, particularly with medium sized businesses that have outgrown their present banking arrangements. Many such companies are on the threshold of strategic and financial change.

We will of course be offering a range of banking services. Credit facilities – short or long term, secured or unsecured – will be available for working capital, bridging finance and capital investment requirements. Loans will normally be made on a floating rate basis in amounts ranging from $500,000 to $3 million or more on a syndicated basis. Australian Bank intends to develop the capacity to deal in foreign currencies and provide hedging facilities via the hedge market. It will provide trade finance and arrange foreign currency loans.

In addition, the Bank will advise on corporate finance matters. We hope to arrange and underwrite new issues in the local capital market and assist clients in evaluating tenders for the underwriting and placement of their securities. We will provide professional advice on investment evaluations, company restructuring and business strategy. Advice on mergers and acquisitions will include takeover defence strategy, letters of fairness, and negotiation assistance. Additionally, Australian Bank will provide expertise in project finance particularly for natural resource and capital intensive manufacturing industries.

Professional Excellence

This brings me to the second cornerstone of our strategy, professional excellence. Obviously, Australian Bank has no intention of trying to become Australia's biggest bank. However, we do intend to become the best in the eyes of the markets we serve.

To do this, we will organise ourselves in a different manner from the established banks. We intend to have a number of Account Officers who will be responsible for Australian Bank's personal banking services to individuals, professional firms and partnerships. The Account Officer will not have administrative responsibilities, but will be concerned solely with understanding the customer's business and in assisting him to meet his financial requirements. The Bank's customers will never be shuffled from window to window; rather they will continually be dealing with a skilled officer who is cognizant of their entire relationship with the bank and is committed to provide real value to him.

Product/Market Segmentation

A third critical element of our strategy, related to the previous two, is to concentrate on those professional services which provide the greatest economic value to our customers. Correspondingly, we will concentrate our marketing efforts on those customer groups which can derive the greatest value from our professional approach.

Competitive Advantage

The fourth and final cornerstone of our strategy is the concept of competitive advantage. Our business strategy is explicitly designed to both build upon our competitive strengths and recognise our weaknesses.

For example, we plan to open one office each in the centres of Sydney, Melbourne and Perth; we do not have a branch network nor any intention of creating one. Obviously, this poses some significant constraints on both the customers we can serve and the services we can offer. On the other hand, the lack of a large and expensive branch network also affords us some competitive advantages in terms of our cost structure and the methods by which we can operate. Similarly, our small size imposes some constraints but also provides opportunities for Australian Bank.

Implementation

By now you will, quite rightly, be asking how and when we will be implementing this strategy and providing these services. The answer is very soon.

I think certain facts about Australian Bank have been well publicised to date and I need not therefore elaborate on many aspects. Suffice to say, Australian Bank is the first trading bank to be formed in Australia for nearly 50 years and holds an unconditional authority to conduct banking business standing in the same relationship to the Reserve Bank of Australia as the other four major trading banks. We have an issued capital of $30 million subscribed by fourteen shareholders, none of whom holds more than 10% of the equity, and the names of which have been well publicised.

Australian Bank owns 60% of a money market subsidiary, Australis Securities Limited. The remaining 40% is ultimately held as to ⅓rd each by Banque de Paris et des Pays-Bas (Paribas), A.G. Becker Incorporated and S.G. Warburg & Co. Limited.

Warburg is a member of the Accepting Houses Committee in London and provides a full range of merchant banking services in the United Kingdom and internationally.

Becker is a leading investment banking house with offices in the major cities of the United States. It is one of the largest dealers in the commercial paper market in the United States.

Paribas has total assets of more than US$50 billion and is consistently a major manager and underwriter of international issues.

Of these, Paribas, is probably the one which is least known in the Australian community. To fill in some details: Paribas is easily the most profitable financial institution in France and has a larger market capitalisation than any other financial institution in that country; in fact, in terms of market capitalisation Paribas is the sixth largest company in France. Paribas is an investor for its own account and has, according to independent studies, been easily the most venturesome of the world's big banks. It has taken stakes in natural resource exploration in Australia, in fast moving conglomerates in Canada and the United States and, most recently, has started dabbling in the hot new field of genetic engineering.

In recent years Paribas has been a bank of coups. Last year, it was Paribas' emergence as the lead manager of the World Bank's first Eurobond issue. This year, it was the acquisition of a 35% stake in one of France's and Belgium's biggest industrial groups, Empain-Schneider. That deal was described by a French newspaper as "one of the most important events in the industrial life of our country in the last twenty years".

We intend having a very close working relationship with Paribas, Warburg and Becker.

In order to undertake these tasks Australian Bank currently has a staff of more than seventy and within the near future this will be approaching one hundred and twenty-five.

It looks as though we will be fully operative early to mid August. Some will be aware that we have been operational in some areas for a considerable period of time.

Banking in the 1980's

Now that you have a basic understanding of what Australian Bank is trying to achieve, the products it will offer and its methods of operations, I would like to address the question of the environment in which it, and all of us, are likely to operate during the 1980's. Obviously, there has to be a considerable amount of crystal ball gazing involved in attempting to prophesy the likely structure. However, with this caveat I will attempt the task.

There has been an increasing trend within Australia and, more particularly, within the United States for financial institutions to increase their range of activities to a point where they can be considered *"financial service conglomerates"*.

In Australia, each day we read of a new service being offered by stock brokers, life companies, building societies, merchant banks and to a lesser extent, trading banks. My prophecy is that this trend will continue so that each of these institutions will endeavour to provide every possible customer, whether corporate, individual or Governmental, with products to meet every possible financial need of that entity. These conglomerates will be built around existing entities whether they be trading banks, merchant banks, stock brokers, life companies or building societies.

There can be little doubt that the Campbell Report will have an impact on how this will come about and what constraints will be imposed on each of these entities in trying to achieve the goals I have imposed.

In attempting to summarise my picture of the goal I can do no better than to quote Mr. Walter Wristom, Chairman of Citicorp, who has described Merrill Lynch as an entity which offers the public "the financial services of the bank of the future".

Just what does this "bank of the future" do? Merrill Lynch states in its annual report that it provides a full line of banking and investment banking services. Despite the fact that it is believed to be the world's largest broker, less than 30% of its income derives from commissions on listed stocks. The rest of the revenue comes from such diverse sources as option trading, investment banking, insurance sales, money market funds, government bond trading, interest income and real estate sales.

It also provides a highly professional accounting service to its customers. Merrill Lynch has tied a comprehensive monthly statement for its clients, one which amounts to a sort of financial review of his or her whole portfolio, together with a money market fund, a cheque book and a credit card, to produce the cash management account, which pays money market fund rates and provides a complete integrated summary of the client's financial position. It also lets him use a visa card and a chequing facility, provided by a regional bank, Bank One of Columbus, Ohio, to make his illiquid holdings liquid.

This march towards financial services conglomerates has quickened its pace during recent months in the United States. In the past three months, for instance, three big American securities firms have been swallowed up by companies from outside the business. For instance, Shearson Loeb Rhoades, the second biggest brokerage house in the United States has merged with American Express.

Dependent only on Campbell, I believe the pace will also quicken in Australia. This then is my picture of the likely Banking scene in the 1980's. As I mentioned, the one factor which will have a more significant impact on that environment than any other is Campbell.

The Campbell Report

It would be presumptuous of me to attempt to prophesy the major recommendations of the Campbell report and I therefore have no intention of doing so. However, it will impact substantially on Banking in the 1980's, so a few comments may not be considered too presumptuous.

Most expect that the Campbell report will make recommendations in relation to deregulation. I believe this is a somewhat narrow interpretation of what the final Report will say. It will probably talk about increased regulation in some sectors.

Obviously the involvement of Government in the financial system is a fundamental consideration before Campbell. However, I would remind you that the Committee has already stated in its Interim Report that it "sees it as necessary . . . to examine Government regulation, existing or proposed, on the basis of the costs and benefits which it generates". The Committee has also pointed out that it is aware that many of the costs and benefits are non quantifiable and that a balance often cannot be struck without facing up to such social questions as the desirability of home ownership and changes in income distribution. The Committee went on in its Interim Report to state that in its final report "it will *not* be expressing judgments on the desirability or otherwise of the Government's various social and economic objectives, except where these relate directly to the efficiency and stability of the financial system". It sees its role as "identifying the nature of the costs and benefits so that the necessary political decisions can be made on a more informed and generally understood basis; and drawing attention to the alternative methods of achieving these objectives". (See Page 393). Hence, analysis of the existing scenario and comments on the net benefits to the system (or alternatively the net losses) is what I believe is likely to be forthcoming.

Unfortunately much of the discussion on the many and varied subjects being considered by Campbell has focused on the question of entry to banking and has crystallised even more sharply in the sub issue of foreign bank entry. To me the discussion has taken an alarming course over the last three to four months. It is assumed by almost every financial journalist in Australia that foreign banks, and specifically in most cases five foreign banks, will be allowed to enter into Australia.

At the outset I would like to point out that Campbell in his Interim Report didn't pass comment on the likelihood of foreign bank entry and to the best of my knowledge no member of the Campbell Inquiry has ever stated publicly or privately the likely outcome of any particular aspect of the subjects under consideration. In addition, I would suggest the level of debate concerning foreign bank entry has not been particularly substantive. I believe the issue needs to be considered in the context of the substantial present involvement of foreign banks both as owners of financial corporations in Australia and as direct participants in Australian financing from overseas. The question then becomes whether participation by foreign banks in the general business of banking will yield net benefit to Australia over and above that derived from their existing involvement in financing and the provision of financial services.

The Committee has also recognised (See Page 426) in the Interim Report that any foreign bank operations should not compromise the scope for effective economic policy. The significance of international transactions for Australia and their important and varied linkages with the domestic economy make the exchange rate of central importance to the Australian economy. Regardless of what Campbell reports I see this as the most vital aspect on which Government policy will be formulated in relation to the entry of foreign banks.

In summary, I do not believe there will be a simple statement by Campbell that five foreign banks should be licensed to operate within Australia. At best, I see Campbell reporting that there are obvious benefits to the granting of such licences and obvious costs and that it will be a matter of Government policy after that which determines whether the foreign banks will be allowed to enter the Australian market place as fully licensed operations. Such policy involves the control of the exchange rate, a particularly sensitive area, and, in any case, we all know how long Governments take to effect major policy changes.