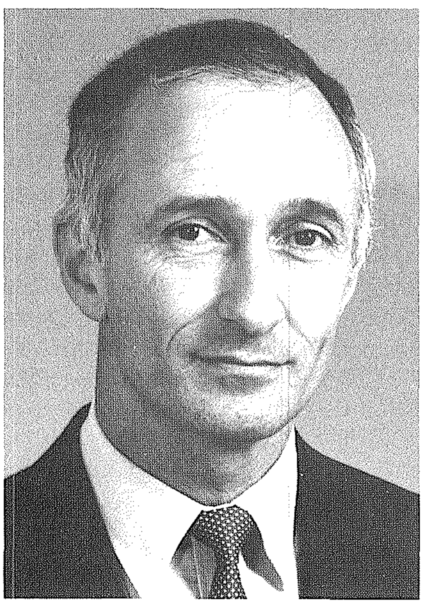
HOW THE BANKS FELL FROM GRACE
DEREGULATION AND THE ANXIOUS CUSTOMER



by *TONY AVELING*

In their rush to adjust to financial deregulation and to embrace technological change, Australia's major banks lost touch with their customers. The next decade should see improved relationships.

The face of banking in the 1990s will be characterised by its overriding emphasis on the customer. Banks will be customer-driven enterprises, competing for business on the basis of quality of service, with products designed to meet specific needs, and delivery systems tailored to provide even greater convenience.

In fact, I shall argue that this is largely the case now. What will be new is the banks' reactions to the collective recognition that customers have expectations of banks which far exceed their needs for financial services. We are finding that customers now want more information, more education, more advice. And they want personalised, individual assistance.

While technology and deregulation enabled banks to grow more sophisticated in their ability to meet the financial needs of the customer, along the way we tended to lose the personal, friendly contact which used to be a feature of all bank transactions.

Banks have lost some goodwill because at times they simply haven't performed. However, banks have also lost goodwill because of a failure to educate customers about how they have benefited from the multitude of dramatic, often complex, and extremely rapid changes in the banking industry.

Banks must now ensure that the deregulated, high-tech environment really does work for the individual, to retrieve the lost ground in the banker-customer relationship. All the benefits of convenience, product innovation and efficiency will count for nothing if customers do not *believe* they are getting a better deal.

I shall be looking at the benefits that deregulation and the use of technology have brought to the customer, and the radical changes they have made to the face of banking. I will discuss how banks are approaching some of the problems associated with those changes, and then look through the crystal ball to see what we may expect in the near future.

Let me review the scope of the changes which have taken place in recent years. First, two examples.

You will recall the low interest rates your savings earned before deregulation. But do you recall the special arrangements you had to make to withdraw those savings from anywhere other than your local branch? Whereas now you can have your pay credited in Sydney and, a few minutes later, withdraw your funds in, say, Cairns, Hobart or Perth – generally, at no cost.

Remember, too, the conditions you had to meet to qualify for a bank home loan, and the expensive "cocktail" loans that were necessitated by the rationing of funds? Now, all the banks and building societies and credit unions and finance companies are after your

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business – and competing hard to get it.

Deregulation

The major beneficiary of the changes brought about by deregulation is undoubtedly the customer. These benefits include:

- innovation in products – new products to meet the needs of different market segments, a greater range of products which customers can choose;
- fierce competition between banks and other financial institutions, providing an even greater choice for customers;
- improved levels of service, particularly in the delivery of products;
- pricing policies closely attuned to costs of providing specific services;
- returns on savings which now reflect market values; and
- the greater availability of funds for lending, especially for housing.

There can be no doubt that deregulation has increased the level of services to the customer. It is unfortunate that, in recent times in particular, attention has been diverted from this to high interest rates and banks' profits.

Bank-bashing is still in vogue but, happily, there now appears to be more widespread acceptance – helped by the Government's own statements – that high interest rates are the deliberate policy of the authorities, employed to slow the growth in demand and ease Australia's balance-of-payments burden.

Banks do not profit from high interest rates, as Graph 1 shows. Witness the decline in interest income as a percentage of interest expense registered by Westpac, ANZ and the NAB in the latest half-year.

Putting it even more simply, we are currently receiving 17 per cent on each new housing loan we make and yet we are paying more than that for many of our interest-bearing deposits. So, at the margin, we are losing every time we make a new housing loan. Hardly profiteering, and certainly sharing the burden!

Two other reasons banks don't like high interest rates:

- Demand eventually drops off, and therefore we do less business.
- High rates hurt many of our customers and, like any organisation that cares about its customers, we feel that too. In fact, we have gone to considerable lengths to cushion the impact of high housing rates on our customers, primarily by lengthening the term of the loan and leaving repayments unchanged where interest continues to be covered.

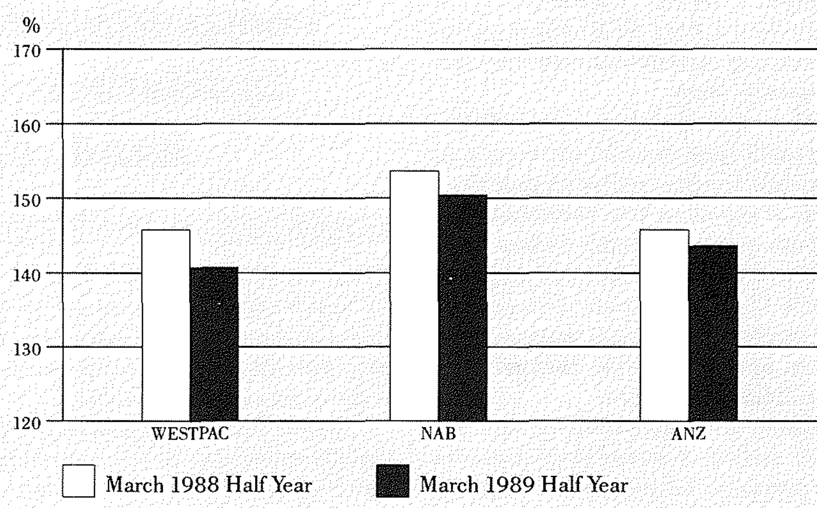
The growth in bank profits has been largely a function of growth in assets. No longer constrained in their lending activities, as was the case before deregulation, banks have extended into new areas as they have sought to meet the demands of the expanding economy. This is most evident in the area of housing: Westpac's housing portfolio increased by 30 per cent in the year to March 1989.

When we look at the return on assets, there is no evidence of profiteering. Looking at Westpac's results over the latest half year, our return on average assets fell to 0.81 per cent from 0.84 per cent in the September half. That is, just 81 cents per $100 of assets.

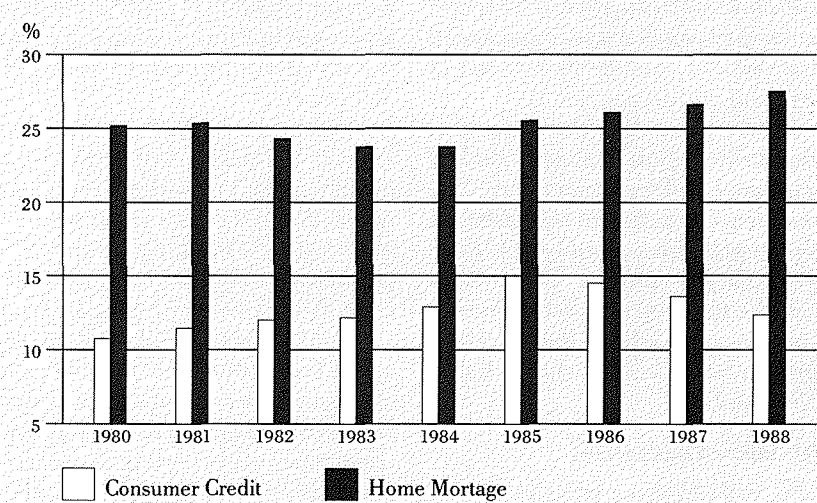
Returning to the level of service provided to the customer, the role of technology in this is nowhere more evident than in the expansion of electronic banking to improve the delivery of bank products. This has led to the more efficient processing of transactions at greater convenience to the customer evidenced by the growth of customer-initiated transactions processed electronically from 10 per cent in 1983 to more than 35 per cent today.

The customer now determines the time, place and method of his or her financial transactions. Three examples in particular emphasise the benefits to the customer:

Graph 1: Major private banks – interest income as percentage of interest expense.



Graph 2: Household debt/household disposable income (%)



The establishment and expansion of the automatic teller machine network gives customers access to their accounts seven days a week at all hours of the day. Westpac customers have access to more than 1,600 ATMs through our interchange agreement with the Commonwealth Bank.

The introduction of EFTPOS (electronic funds transfer at point of sale) terminals provides access for purchases made at supermarkets, service stations and other selected retail outlets. Customers of major banks have access to nearly 11,000 point-of-sale terminals nationally through interchange agreements, and this number is expected to soar in the near future.

Home and office banking facilities allow extended access to accounts by telephone or by personal computer. Westpac's customer base for this facility has expanded to more than 70,000 in just two years of operation.

Among other technological developments in banking which have benefited customers are on-line front-office terminals, designed to reduce customer paper at the branch counter and speed up transactions, and the direct entry of payroll and pension payments.

Clearly, technology has allowed us to adapt to the rapidly changing needs of the customer and the marketplace. The competitive environment has required banks to pay close attention to those needs and expectations. This is consistent with the principle that improving the quality of products and services hinges on being able to stay in touch with customers.

Why the criticisms?

So, with all these benefits for the customers from the combined impact of technology and deregulation, and banks bending over backwards to anticipate and meet customers' needs, why have we seen headlines in the popular press speculating on our parentage?

I believe many of the comments directed at banks have been a reaction to change itself – especially to the extent and pace of change.

To paraphrase Hugh McKay, the social researcher, the Australian consumer is anxious. Anxiety, he says, is the inevitable product of the instability which flows from change.

I believe that we, as bankers, have been slow to recognise the social impact of the changes in the banking industry on our customers. We have focused on the benefits of improved products, greater choice and enhanced convenience. We did not always foresee the consequences of the changes in social terms.

Let's be driven by healthy competition between financial institutions, not by the dead hand of legislation.

Banks formerly were an exceptionally stable part of the community. Banking services were no surprise, either! Bankers were respected, authoritative figures – the father-figure who said "no", the disciplinarian who made you save a little longer before rewarding you with a loan.

Now, of course, things could hardly be more different – fierce competition, rapid entry and exit of competitors, a huge variety of products and you get what you pay for!

Since deregulation, there have been new entrants to the market, the disappearance of long-standing institutions through mergers and takeovers, and some "changing of spots" by building societies and other financial institutions which have become banks.

Add to this the other changes to which I referred earlier – a wide variety of largely new products, new methods of delivery and unfamiliar pricing policies – and you can see the scope for confusion and insecurity, perhaps even suspicion.

Let me now elaborate a little on the more important changes, and look at some of the initiatives banks have taken to improve their relationships with their customers. The first I shall address is the emotive subject of transaction charges.

Traditionally, transactions were free to customers, although they have always represented a cost to banks. Transactions were cross-subsidised by the payment of a below-market rate on deposits. However, as interest rates on deposits have become competitive, banks have moved to "unbundle" services and price each separately.

Westpac's approach has been to introduce transaction charges only on products which were made substantially more attractive to customers. For example, Westpac's Advantage Saver account offers cheque and card access, more frequent payment of interest and improved interest tierings. Accounts with a minimum balance of less than $500 are entitled to six free transactions a month. Double that number are free on accounts with more than $500. Deposits are not counted as transactions unless they contain cheques. Young people receive extra benefits as they start to establish themselves in life.

The figures and tierings in the account were reached following extensive market research and consultations with governments, consumer representatives, customers and staff, to ensure that poorer members of society would not be disadvantaged.

What we see from this is the fairer treatment of customers. Customers are charged according to the services they use. After all, what other *private* enterprise is prepared to cross-subsidise its range of products and services?

The user-pays principle should be the basis of all financial services if true equity among customers is to be achieved. However, cross-subsidisation on credit cards is enshrined in legislation. I am talking here about the free service enjoyed by those people who elect to pay off their bankcard accounts in full each month. Good luck to them, but let's remember that they are subsidised by the high interest rates paid by those who make use of the extended credit facility – often the poorer members of our community.

Clearly, it would be more equitable if the former group paid in some way for the service they use, thus separating the two services – convenience and credit – which credit cards provide. The legislative restriction preventing a mix of an annual fee and interest rates not only forces the continuation of cross-subsidisation, it hinders innovation and competition.

Westpac doesn't have any particular

barrow to push and if the Australian people want legislation which effectively forces those using extended credit to pay the costs of those who get the service for nothing, then so be it!

Some of you may recall, though, that last year Westpac promised that any new fee would be offset by a decrease in the interest rate – and I repeat that promise. If, like the credit unions, banks were allowed to charge both an annual fee and interest, any change from one to the other by Westpac would be revenue-neutral to the bank.

And, by the way, you can't take it out of credit card profits – there aren't any!

Let's be driven by healthy competition between financial institutions, not by the dead hand of legislation.

The level of consumer debt seems to follow naturally a discussion on credit cards. However, I am pleased to note that studies undertaken by bodies such as the Economic Planning Advisory Council and consumer affairs agencies have concluded that consumer overcommitment is *not* a widespread problem. Indeed, household debt as a proportion of household disposable income has been declining since 1985. A steady increase in the home mortgage component of that debt has been outweighed by a reduction in consumer debt (see Graph 2).

Where overcommitment does occur, its major cause is changes in the circumstances of the borrower after a loan has been taken out – for example, unemployment or illness.

By international standards, Australians have very moderate consumer credit usage and a low level of bad debts. Consumer bad debts appear to be stable at around 1.2 per cent in respect of credit cards and 0.75 per cent on personal loans. In the United States, bad debts run at about three times this level.

Nevertheless, in response to concerns that the "easy" availability of credit may lead to overcommitment by some consumers, banks have moved to using technology to set up an objective system of assessing credit applications, known as "credit scoring". By taking into account a wide range of considerations, this system facilitates the more effective assessment of capacity to repay and thus further reduces the possibility of overcommitment.

Personal customers will also be assisted in making informed choices by the banks' initiative in introducing a disclosure standard which is to be fully implemented by March, 1990. The disclosure standard will make it easier for customers to compare different interest rates, charges and terms and conditions on all loan and deposit products.

On the question of dispute resolution, you would be aware of the banks' decision to establish a banking ombudsman, who will be appointed by a council on which banks will be in the minority and who will independently investigate and adjudicate where customers' complaints are not resolved by the banks' own internal procedures. Access to the services of the ombudsman will be free, and substantial monetary and other determinations will be possible.

Banks also are working very closely with government bodies in reviewing the code of conduct of EFT services to ensure that individual customers are not disadvantaged by the very technology which aims to provide them with a better service.

Restoring our customer goodwill and our public image will require hard work.

No doubt cynics may argue that banks are merely reacting to problems as they arise. I reject this on two grounds:

- in most cases, we have foreseen the potential for problems and, because we really do value our customers, have actively sought ways of either preventing or overcoming those problems before they have surfaced; and
- the action we have taken on different issues generally goes far beyond what has been necessary to merely solve the problem at hand. We have sought genuine solutions rather than temporary treatments.

As I indicated earlier, I believe that quality of customer service will be the key issue addressed by banks in the years ahead – and indeed it is already receiving serious attention, especially in metropolitan areas where the problem seems greatest.

The quality of customer service can only be improved by focusing on our customers' needs on an on-going, long-term basis and providing our staff with the best possible training and working conditions to meet those needs.

Banks must develop ways of delivering products and services that are tailor-made for individual customer needs while offering a return to the personalised, friendly service of past years.

Looking to the 1990s

I am under no illusions that rebuilding the old banker-customer relationship will be an easy task. Restoring our customer goodwill and, consequently, our public image will require hard work – especially in the fiercely competitive environment in which banks operate. But this will not be achieved by forsaking technological developments. In reality, one will reinforce the other.

The point I would like to make is that, in the 1990s, banks will be asking themselves two questions:

- What does the customer want?
- How can we utilise technology to meet those customer requirements?

In other words, technology will be the servant rather than the master. It will meet customer needs rather than the organisation's needs.

In particular, on the retail side, we will be using technology to help our own staff provide better service to customers. Our staff often work under enormous pressures and we have to find ways of allowing them to get on with the job of looking after their customers, secure in the knowledge that all the information they require is at their fingertips and that we have built systems which will largely eliminate errors.

Deregulation and technology together have had a far-reaching impact on the individual as well as on the banking system.

Technological innovation will continue to spawn new products and new ways of doing things – to the ultimate benefit of the individual customer.

Banks are not altogether altruistic – although we recognise our social responsibilities and the value of being a good corporate citizen. We want to improve our market share and increase our profits.

However, we have recognised that success relies on meeting our customer needs by providing more competitive products and better customer service. Technology and a genuine desire to "do the right thing" by our customers are the keys to success. □