



# Bank Strategy

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11<sup>th</sup> Banking and Finance Conference

Finsia and Melbourne Centre for Financial Studies

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25 September 2006

**Commonwealth** Bank



# The structure of the presentation

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**Trends and challenges in global financial services**

**Recent trends in Australian banking**

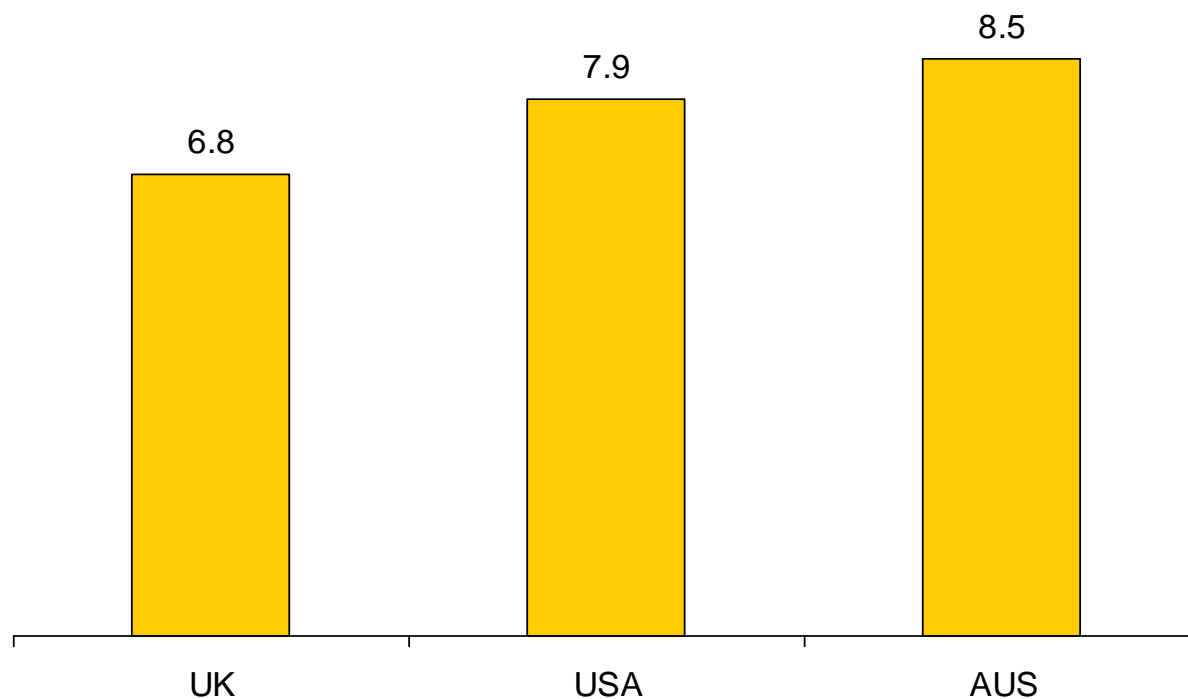
**Strategic issues**



# The financial services sector is big

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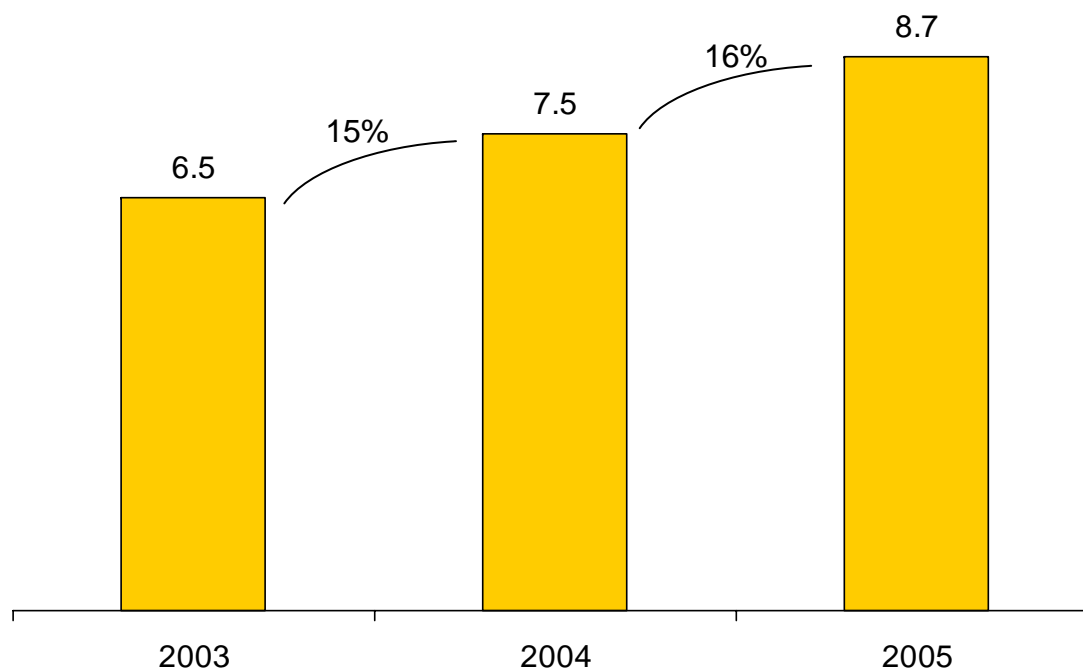
**Contribution of finance and insurance sector to overall GDP (2004, %)\***



# And growing rapidly

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Industry market capitalisation (\$ Trillions)



## And performing well (for shareholders)

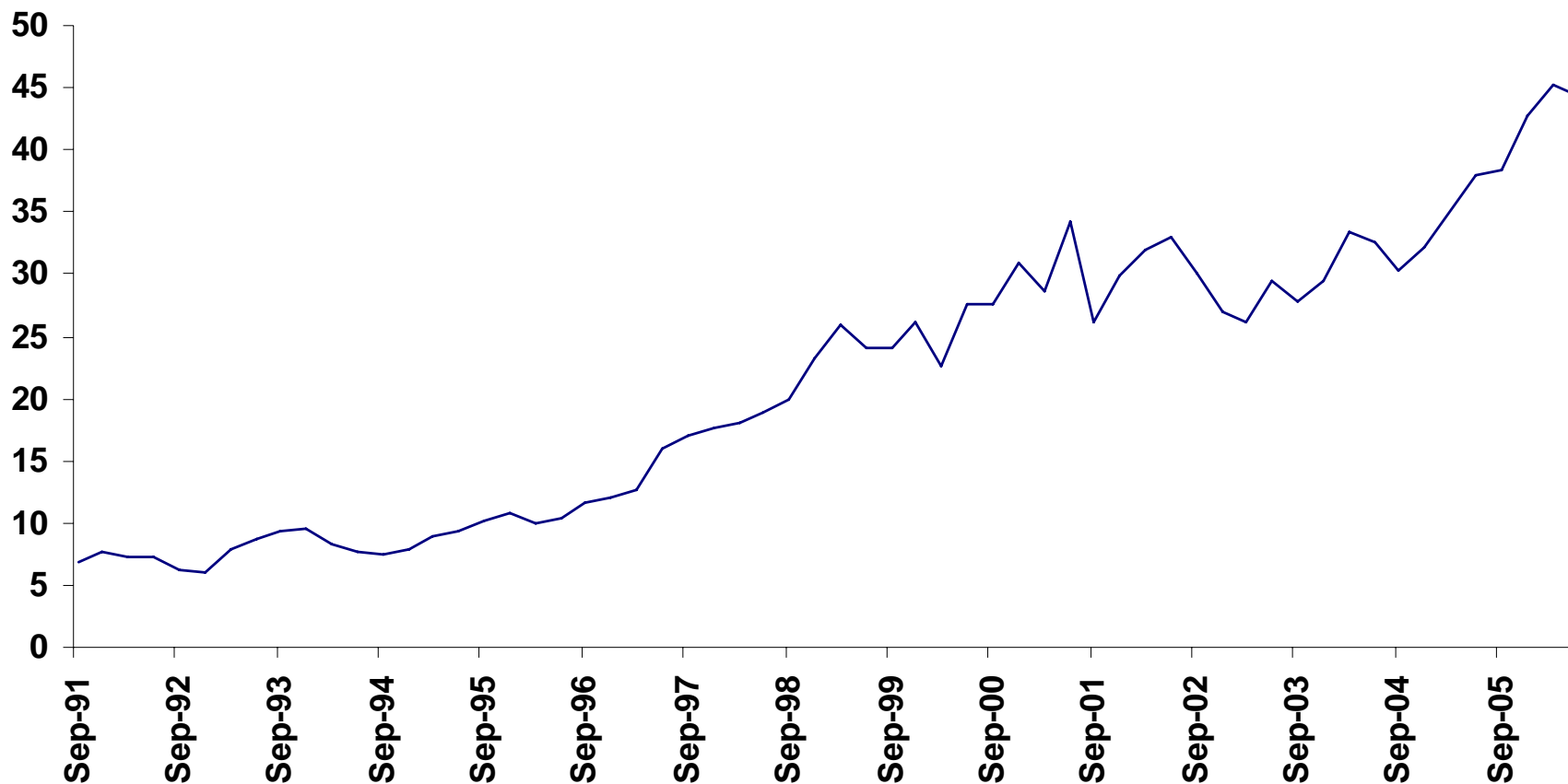
Financial services industry shareholder returns (% , 2000 – 2004)\*



***Financial services has out performed the world average over the last 5 years***

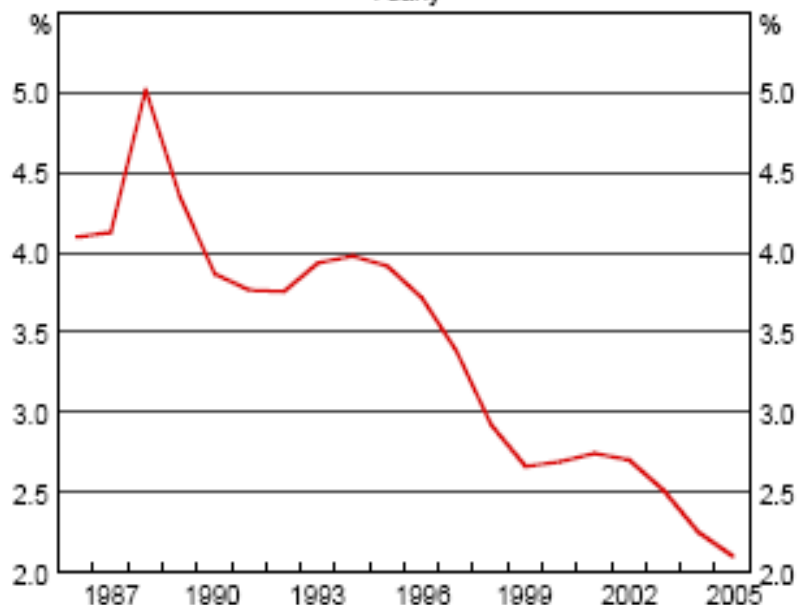
And performing for shareholders eg CBA up 750%, index 300%

CBA Share price (AUD)



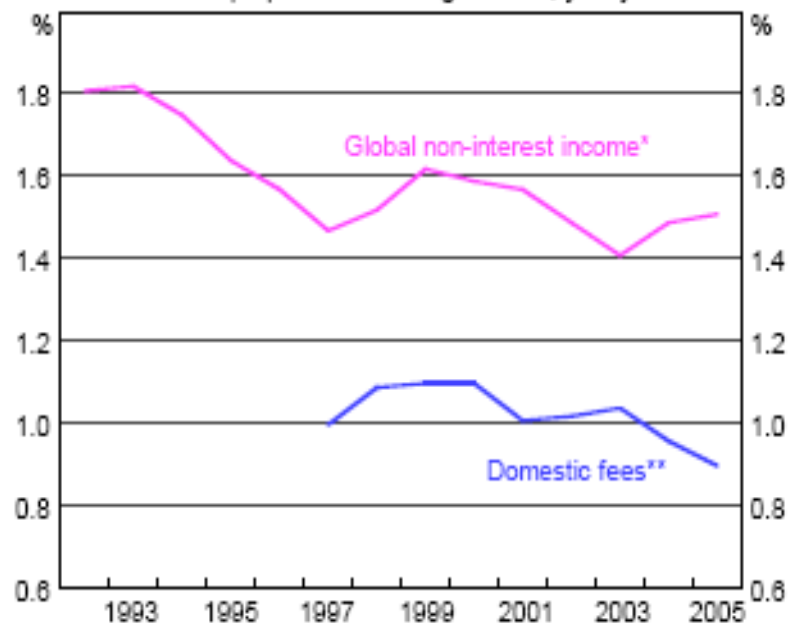
# And performing well for borrowers

**Australian Major Banks' Domestic Interest Spread\***  
Yearly



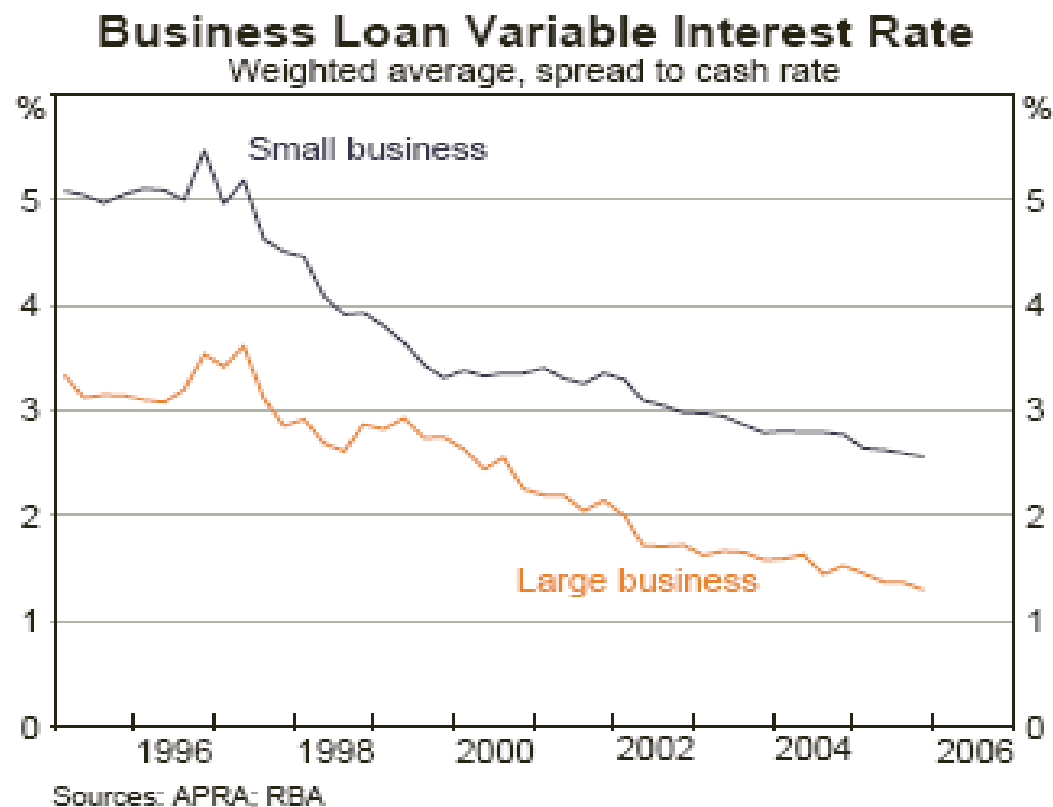
\* Average Interest rate received less average Interest rate paid  
Source: RBA

**Australian Major Banks' Non-interest Income**  
As a proportion of average assets; yearly

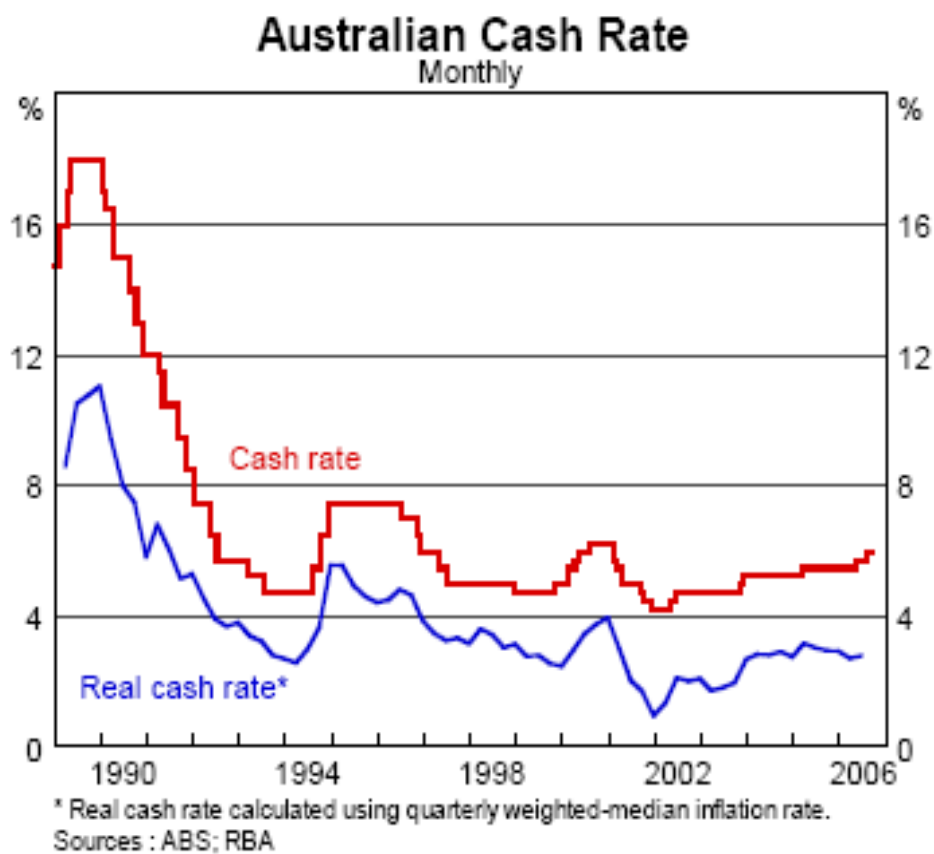


\* Excluding abnormal items  
\*\* Measured against domestic average assets  
Source: RBA

And performing well for borrowers too



## And performing reasonably for lenders



# How is it possible: cost control and cycle – typical\* large bank

**Key banking sector metrics  
(% total assets)**

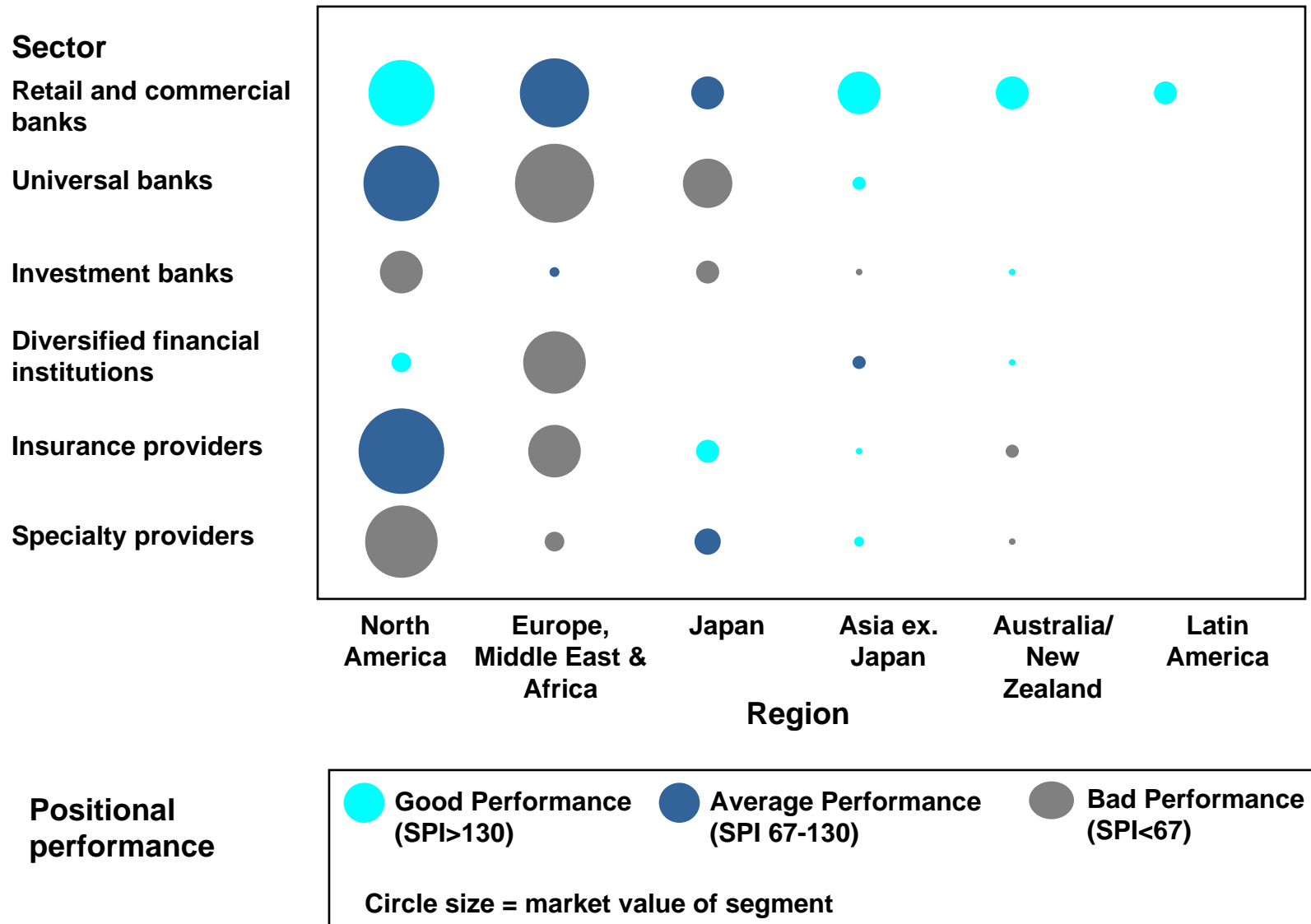
	<b>2003</b>	<b>2005</b>
Pre-tax profits	<i>0.80</i>	<i>0.91</i>
Provisioning expenses	<i>0.37</i>	<i>0.16</i>
Net interest margin	<i>1.86</i>	<i>1.44</i>
Operating costs	<i>2.62</i>	<i>1.99</i>



- Net interest margins have fallen squeezing revenues
- Operating costs and provisioning has been reduced – cutting costs
- Profits have risen slightly



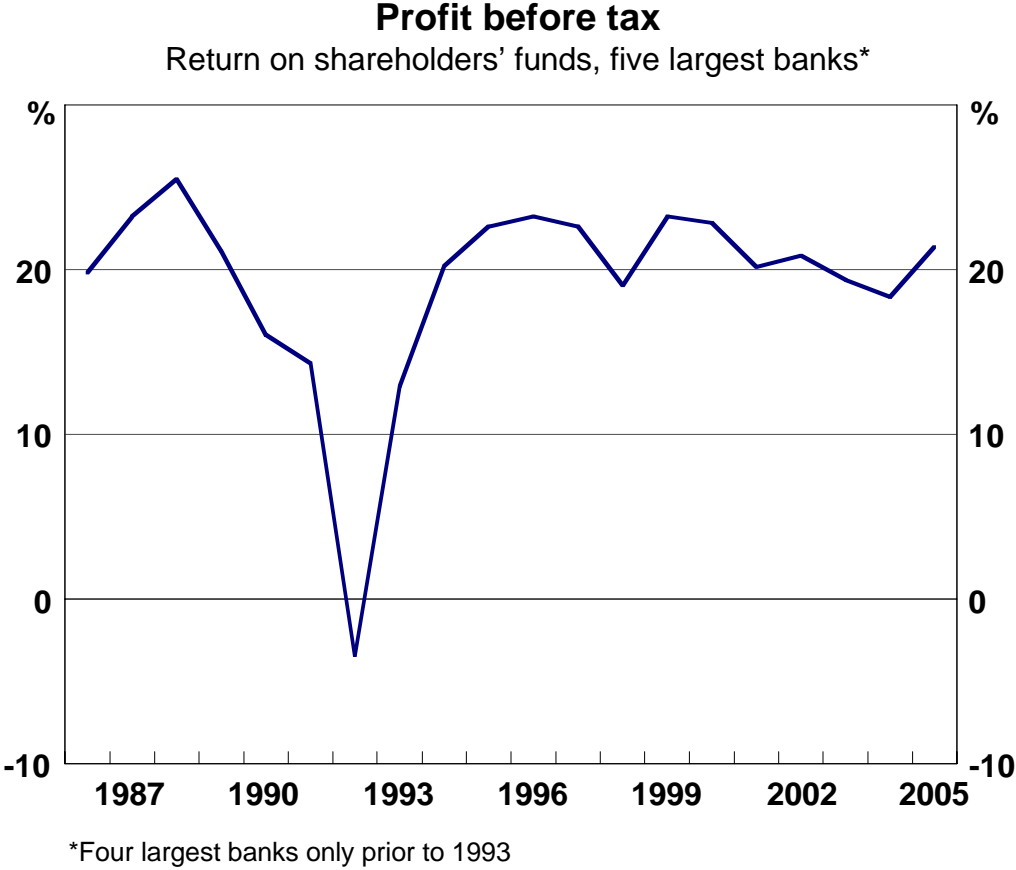
# Global 2005 performance - by industry sector and region



•Source: The state of the financial services industry-2006, Mercer Oliver Wyman

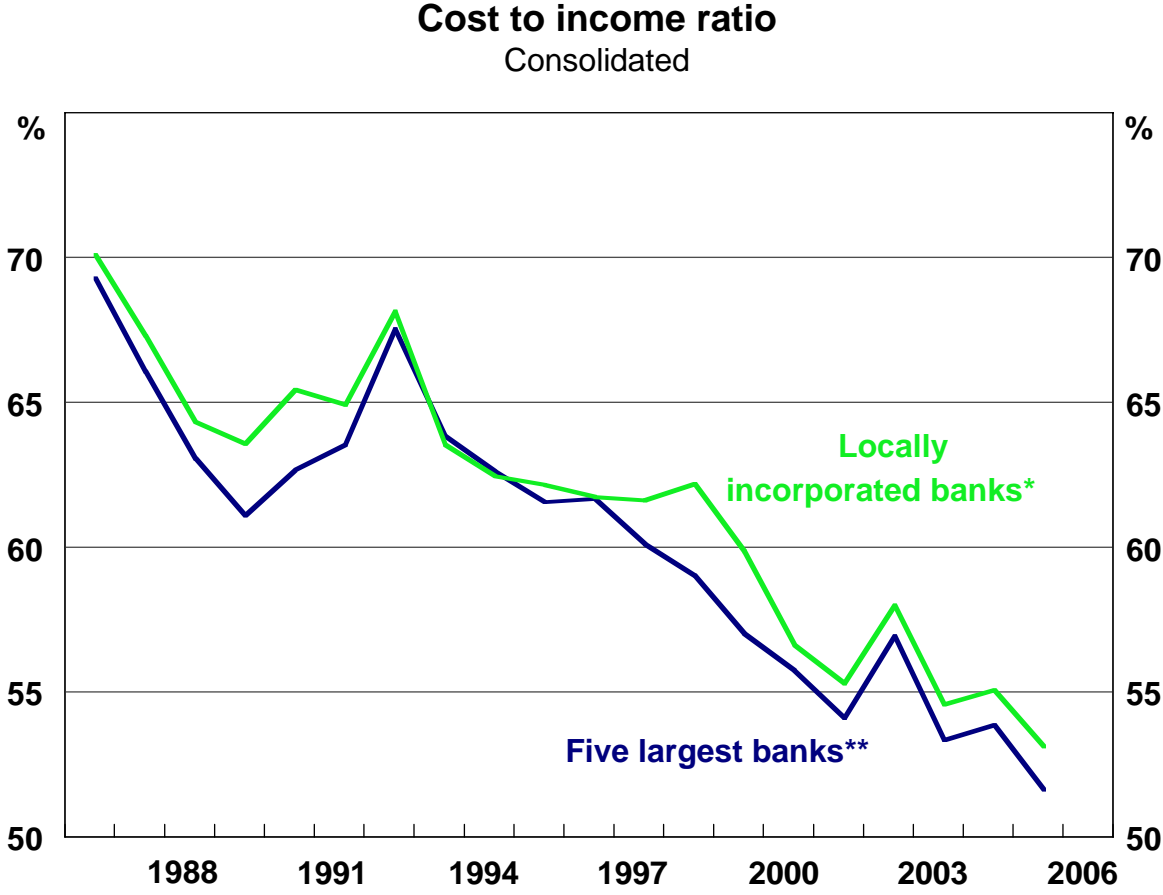


# The same picture is true in Australia



Source: Recent Trends in Australian Banking, Keith Hall and Daniel Veryard, Financial Stability Department, Reserve Bank of Australia

# Cost control continues to be an important driver



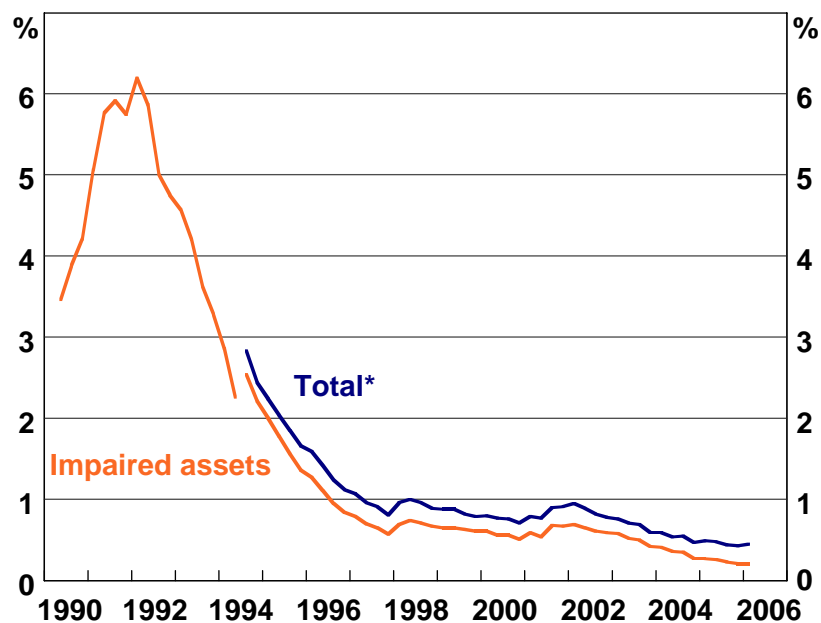
\*Excluding banks that are primarily involved in wealth management or where no data are available

\*\*Four largest banks only prior to 1993

# And the strong economy has helped on the risk side

## Banks' Non-performing Assets

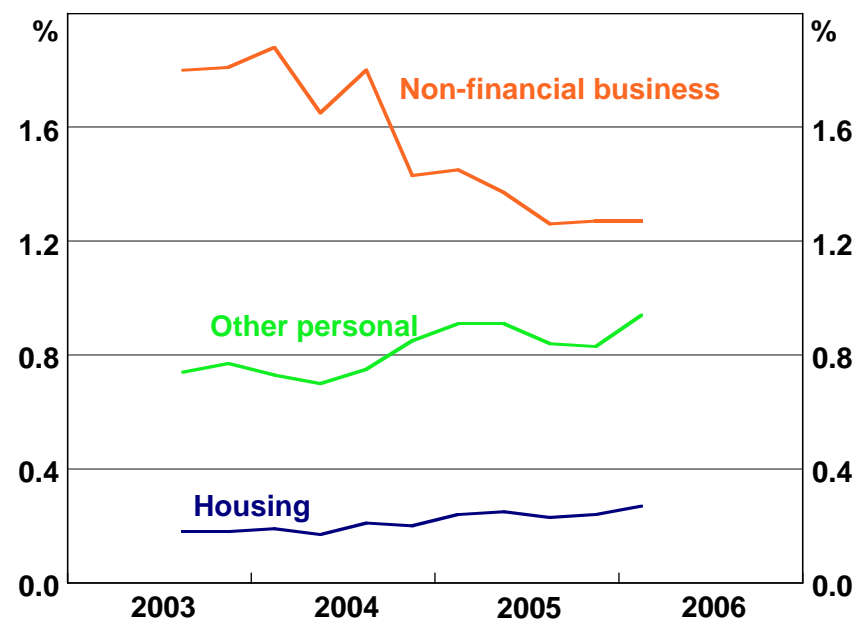
Percent of on-balance sheet assets



\*Includes past-due items

## Arrears Rates

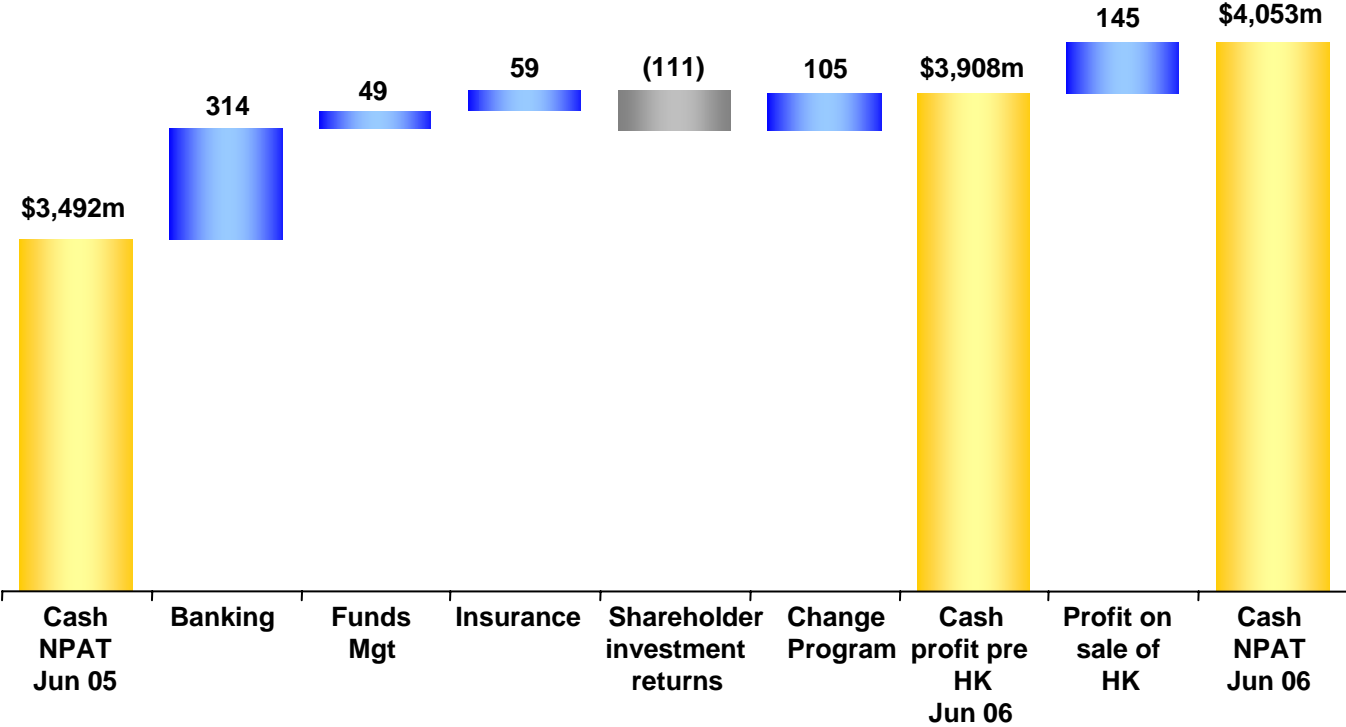
Non-performing assets, percent of outstandings by loan type\*



\*Includes past-due items



# CBA - structure of strong full year result



Scorecard	Jun 06
Volume Growth	✓✓
Interest Margin	✓
Non Int.Income	✓
Expenses	✓
Credit Quality	✓✓
Tax	✓
Cash EPS	✓✓

Cash EPS 264.8  $\xrightarrow{\uparrow 15\%}$  Cash EPS 304.6

# Risks

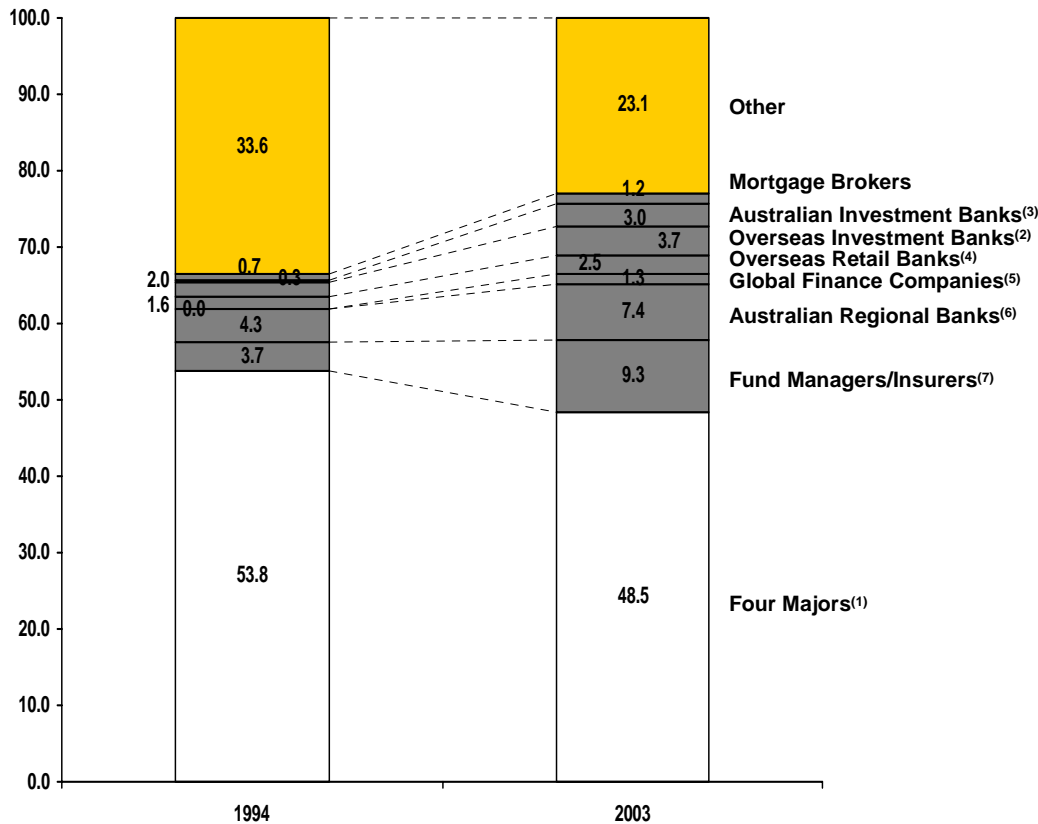
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- Competition and entry
- Changing domestic market
- Rising costs
- Globalisation



# Competition and entry – entry of specialists

**Breakdown of Australian industry net revenue  
1994 and 2003 (%)**



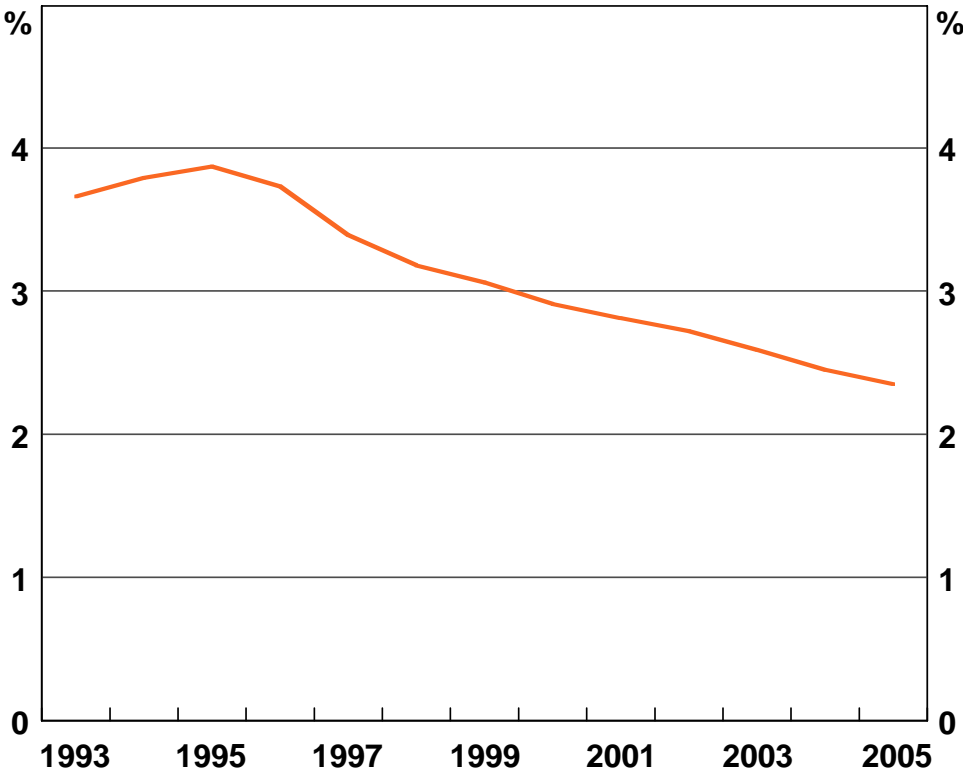
- Adam Smith taught us that specialisation improves productivity
- The same is clearly true in the financial sector where every day there are more providers of specialist services
- A lot of our regulation is focussed around registration of businesses which cover lines of business
- Will we see fragmentation or consolidation? Or both
- Can regulation cope? – consider the recent US moves on hedge funds

(1) Include acquisitions  
 (2) Includes Merrill Lynch, UBS, Deutsche, ABN AMRO, JP Morgan, Morgan Stanley Dean Witter  
 (3) Includes Macquarie Bank  
 (4) Includes HSBC, Citibank, ING  
 (5) Includes GE Capital Finance Australasia  
 (6) Includes St George, Suncorp Metway, Bank West, Bendigo Bank  
 (7) Includes QBE Insurance, Challenger, AXA, IAG. Excludes AMP due to abnormal items



# Competition and entry – hit on margins

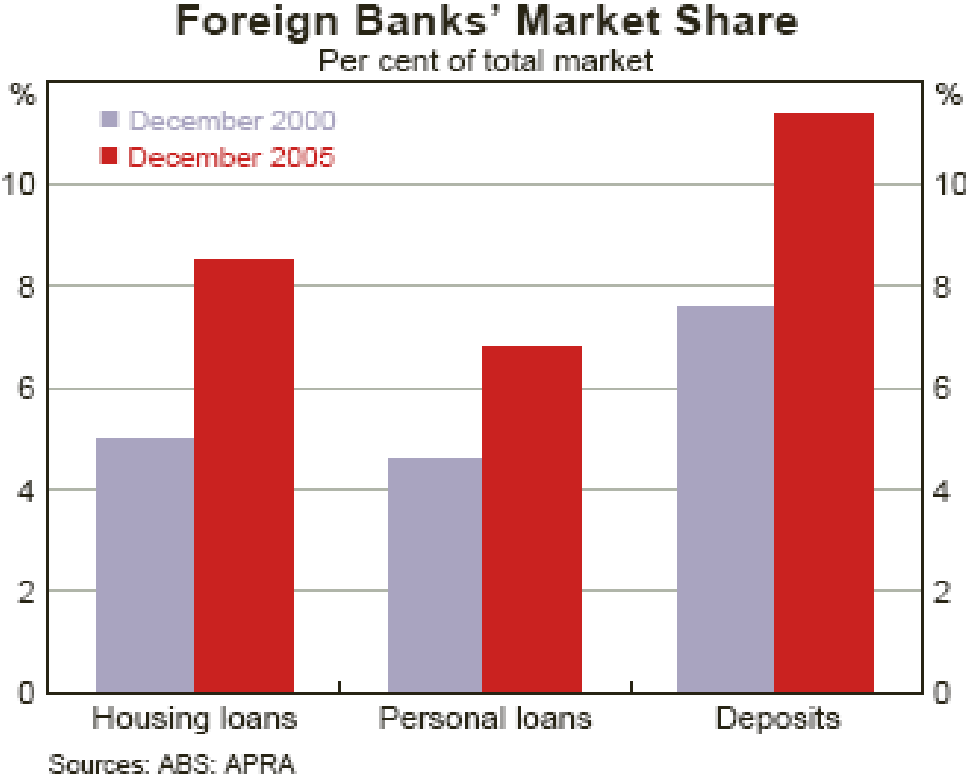
**Net interest income**  
Percent of average interest-earning assets, five largest banks



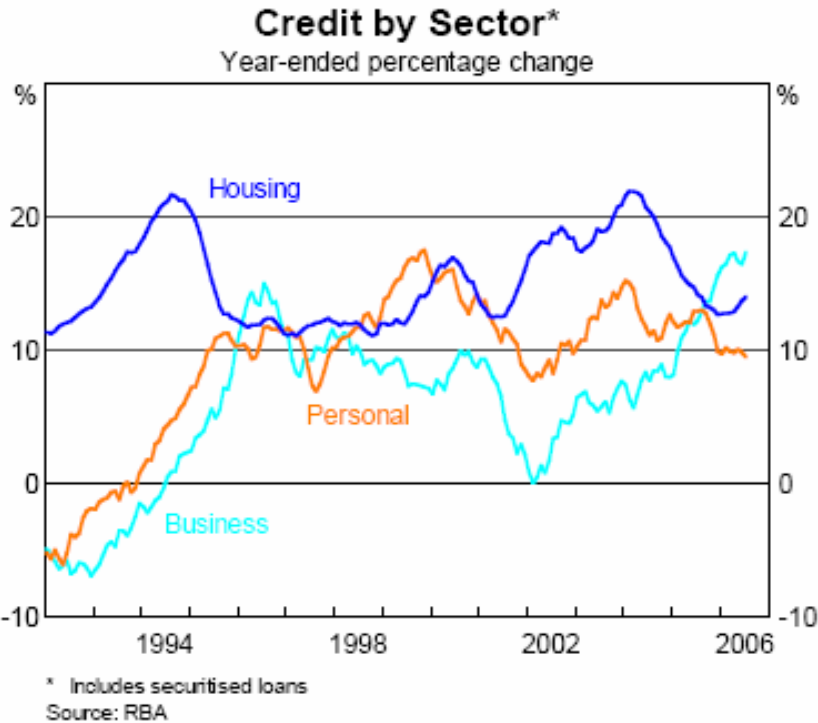
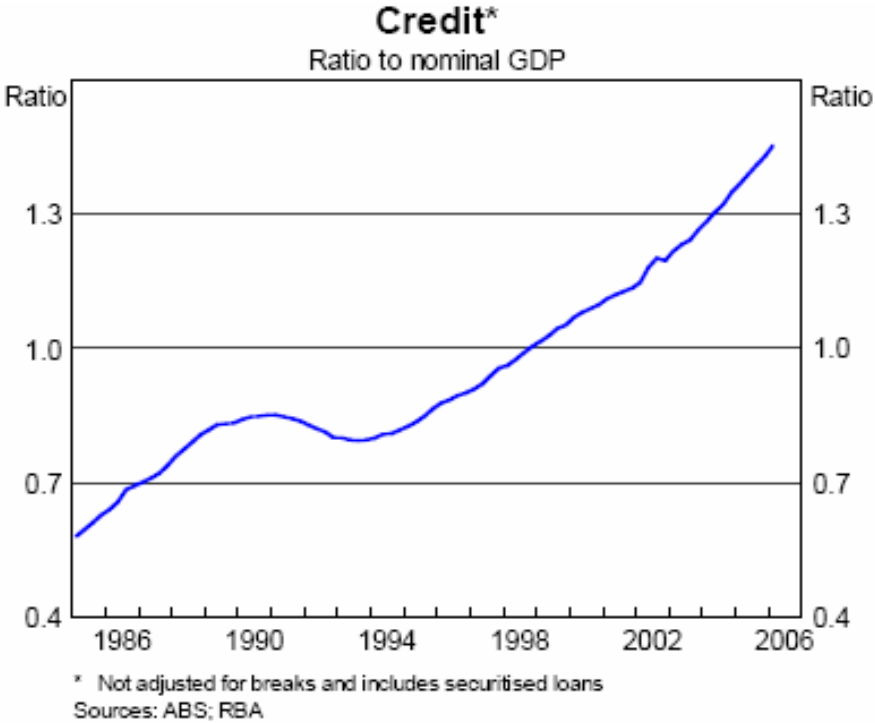
Source: Recent Trends in Australian Banking, Keith Hall and Daniel Veryard, Financial Stability Department, Reserve Bank of Australia



# Competition and entry – hit on market share



# Changing domestic market - switch in direction of borrowing

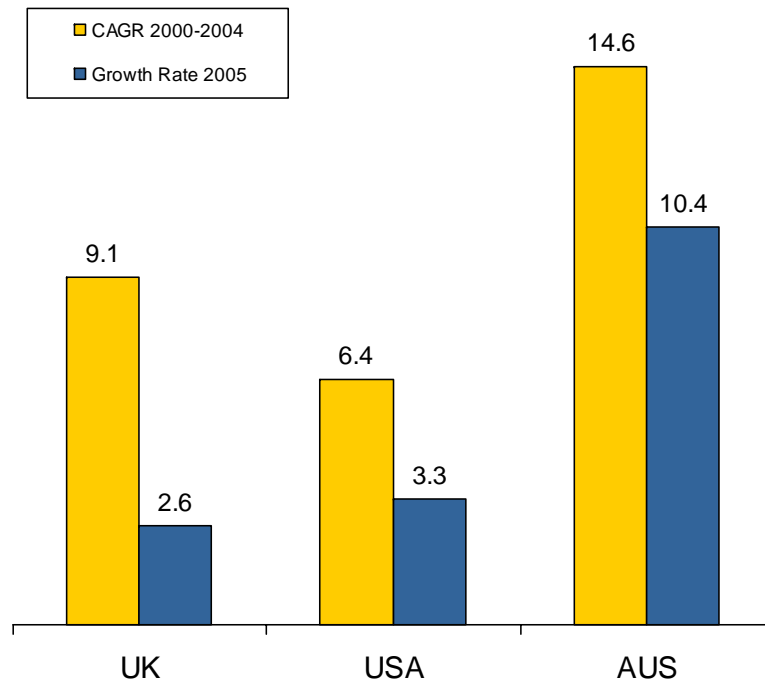


# Changing domestic market – possibly slower economy

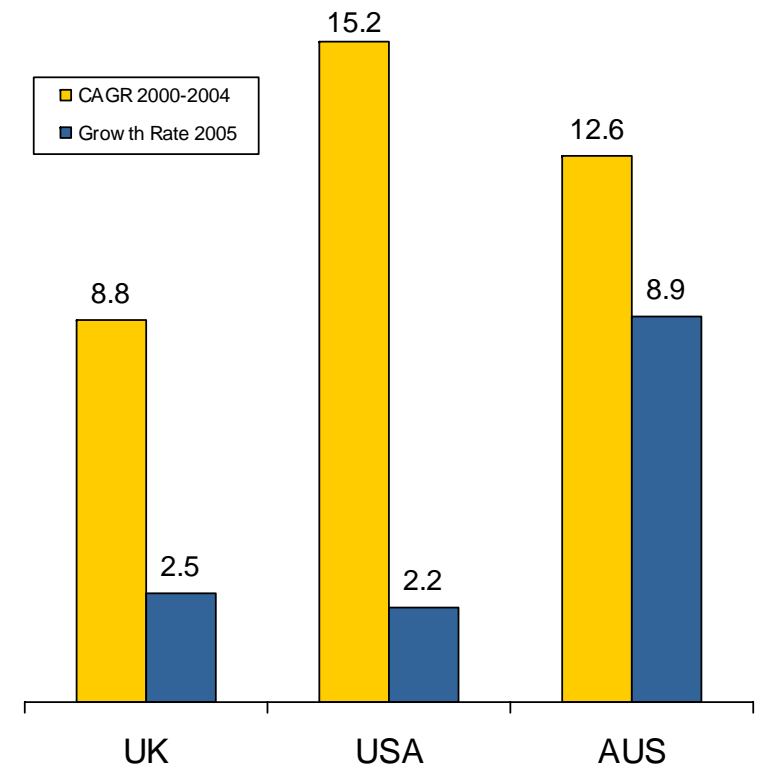
Consumer credit growth cooled significantly in 2005...

...as did deposits

Growth in consumer credit (% , 2000 – 2005)



Growth in consumer deposits (% , 2000 – 2005)\*

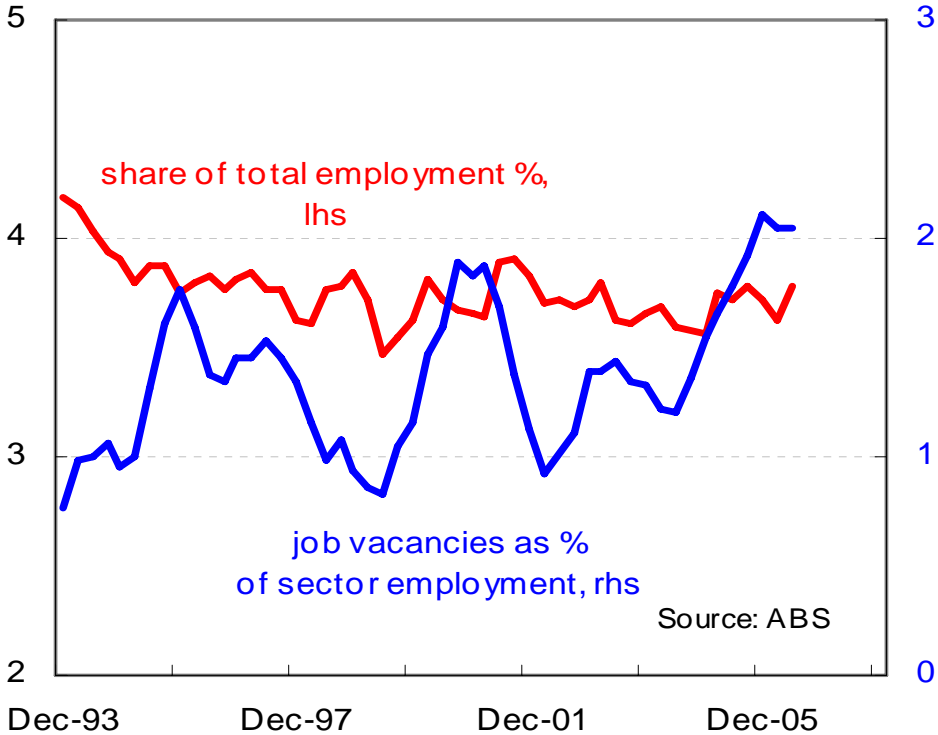


**Challenges appear ahead**



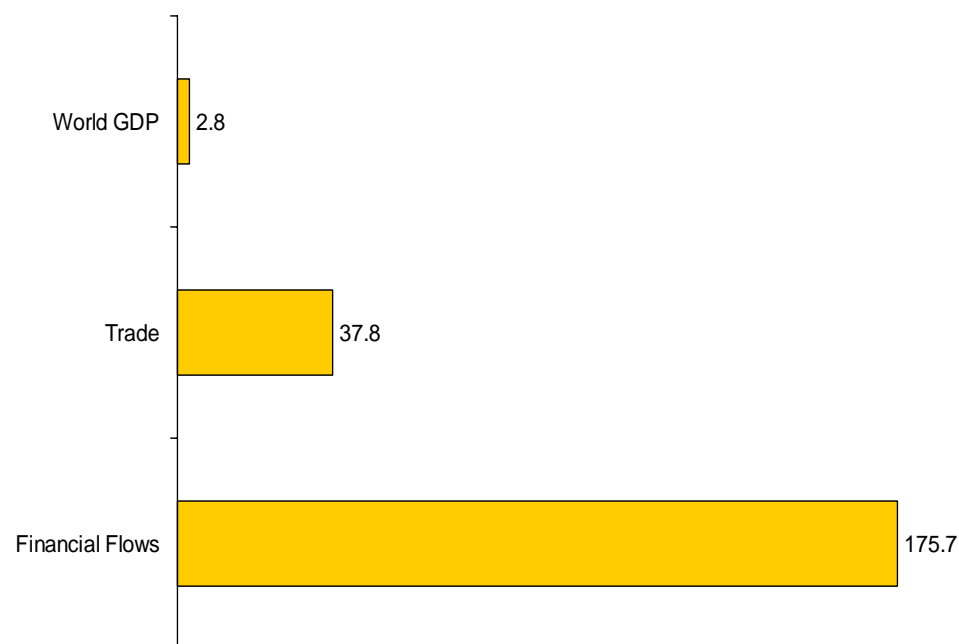
# Rising labour costs – people, ABS data

## FINANCE: JOBS & VACANCIES



# Globalisation of flows

**Percentage growth in world development indicators 1990-2004 (%)**



- World trade is growing much faster than world production
- People, businesses and governments are more interconnected than ever
  
- Global financial flows are growing even faster than world trade
  
- As financial institutions improve resource allocation globally
- And provide better risk management by greater diversification



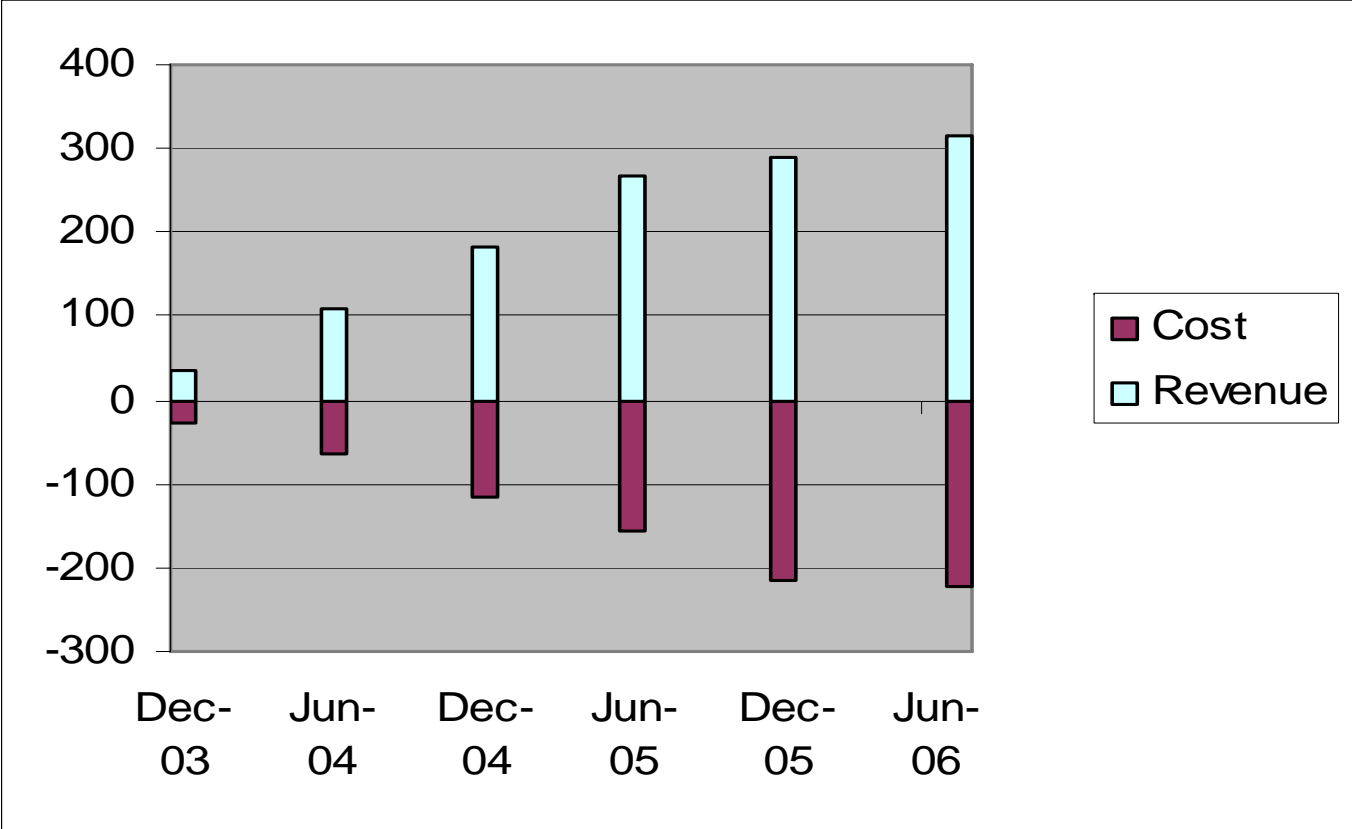
# Strategic responses

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- **Competition and entry**
  - Fix weak businesses
  - Redesign business processes
  - Get closer to customers
- **Changing domestic market**
  - Concentration on business banking
- **Rising labour costs**
  - Work on labour relations
  - Get closer to the community
  - Off-shoring
- **Search for growth**
  - Offshore
  - Improving weaker business lines, cross-sell etc



# Competition/entry - redesign businesses (CBA's WnB, \$m)



## Competition/entry – experiment with business models

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- Increases in debt-servicing ratios - typically now 50% not 30%
  - Use of the broker channel – about 30% of housing loans through brokers
  - Low docs mortgages have now grown to near 10%
  - Increasing discounting of standard variable rate (50 to 70bps)
  - Partly facilitated by narrowing of spreads investors require to hold residential mortgage-backed securities
- New on-line deposit products
- New credit card products
- Switch in funding towards wholesale and offshore markets
  - Foreign liabilities up from 15% in 1996 to 27% in 2006



## Competition/entry – get closer to the customer

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- All stages of the value chain are under competitive pressure
- The customer is king – all the Australian banks are customer focussed

CommonwealthBank



*“A service experience our customers appreciate. **Our highest priority and organisational commitment is customer service**”*

- Ralph Norris, CEO

Westpac

*“Our plan is all about a culture of high performance, trust and empowerment and a real **focus on customer experience**.”- David Morgan, CEO*

 **National**

*“We are stripping out complexity, improving the focus on project management and streamlining our corporate centre...overall goals have to be speed to market, sustainable growth and **customer focus**.” - John Stewart, CEO*

ANZ

*“Delivering sustainable value...involves more than producing superior financial results...also about **ensuring our customers want to do business with us...**” - John McFarlane, CEO*

 st.george

*“We are spending a lot of time **connecting with our customers** and learning how we can improve service delivery.” - Gail Kelly, CEO*



## Changing market – business lending is the current focus

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Our Business Banking market share is 13.1% (June 06) – one of CBA's weakest

Our business banking strategy:

- put business bankers back into branches
- roll-out new client system (CommSee for Business)
- roll-out new business process system (CommBiz)
- re-align performance metrics to align with customer advocacy, market share and profitability
- management/structural changes



## Labour costs – retention strategies and outsourcing

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- All the banks are working on increasing retention of staff
  
- A number have started to offshore work
  - *“Westpac has rejected claims by the Financial Services Union (FSU) that it would announce plans tomorrow to shift 485 jobs from a loans processing department in Sydney to Bangalore in India. It insists a decision is months away”*
  
- Ongoing pressure to keep costs under control
  - 1H06 v 1H05
    - **ANZ +6%, CBA +4%, WBC + 4%, NAB +1%, SGB +1%**



# Labour costs – get closer to the community (CBA's Vision)

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## Our Vision

To be Australia's finest financial services organisation through excelling in customer service



## Search for growth - internationalisation (from RBA's FSR, p31)

**Table 8: Australian-owned Banks' Foreign Exposures**

As at December 2005, ultimate risk basis

	Total		of which:	
	Level \$b	Share Per cent	Cross-border \$b	Local \$b
New Zealand	166.0	45.3	4.7	161.3
United Kingdom	84.7	23.1	17.9	66.8
United States	38.3	10.4	21.2	17.0
Other developed countries	50.5	13.8	47.3	3.2
Developing countries	15.8	4.3	10.0	5.8
Offshore centres <sup>(a)</sup>	10.9	3.0	6.9	4.0
Other	0.2	0.0	0.0	0.1
<b>Total</b>	<b>366.3</b>	<b>100.0</b>	<b>108.1</b>	<b>258.2</b>
<i>Memo: Per cent of total assets</i>			<i>8.0</i>	<i>19.0</i>

(a) Includes Hong Kong and Singapore

Source: APRA



## Search for growth – wealth management

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	<b>Wealth/profit %</b>	<b>Growth in wealth % pcp</b>	<b>Growth in FUM/FUA %</b>
<b>ANZ</b>	2.7	-15.0	9.5
<b>CBA</b>	25.1	33.0	16.6
<b>NAB</b>	27.6	73.3	12.9
<b>WBC</b>	11.1	29.2	10.2
<b>SGB</b>	12.4	26.4	33.6
Source	CommSec, 1H06		



# Conclusion

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- **The financial environment is becoming ever more complex**
- **People, firms and institutions want access to a wider range of services**
- **Technological change, globalisation and specialisation are enabling new competitors**
- **This is good for customers**
- **The big issue for banks is how they can meet the emerging challenges and sustain their excellent performance**

