COSTS, CHANGE AND COMPETITION

A TIME OF TRANSFORMATION FOR BANKS

Since this is a gathering of people with an interest in Australia-New Zealand relations, I had originally planned to open with a comment on the recent World Cup cricket series. However, the fact the Australia lost to a team from a country smaller in size than Tasmania took the edge off my enthusiasm. Whether it be sport, national economic management, or the banking and financial services business, there are obviously no guaranteed winners. The way the game is played constantly changes. Teams need to adapt or become uncompetitive.

Rules need to keep pace with new competitive trends. These themes are relevant today to the Australian and New Zealand economies and our local banking and financial services sector.

When you consider the Australian and New Zealand economies it is clear that the New Zealand team has recently well and truly outscored Australia in some aspects of the national economic management competition. And that’s a very important game to win.

We have an underlying commonwealth government budget deficit forecast of around $8 billion this year, excluding the proceeds of asset sales and advances. This contrasts with the New Zealand government’s expected budget surplus of $2.64 billion – a surplus that has allowed it to significantly reduce personal income tax. Longer-term government interest rates in Australia are around 9%, compared with 8% in New Zealand. Unemployment in Australia is running at 8.5%, compared with around 6% in New Zealand.

It has been suggested that differences in population, economic size and political structures make strict comparisons with New Zealand worthless. I am not so sure. I believe there is one comparative fact that is relevant to Australia. New Zealand’s recent economic success has come about because they have attacked the issue of costs in all its dimensions. They have attacked the costs associated with excessive regulation. They have attacked the costs of unproductive public-sector industries and of highly regulated labour markets. They have also attacked the costs of protected, cosseted industries.

Now once a government takes the lead in cost-cutting, the private sector simply has to respond. And that has been critical to New Zealand’s recent success. Whether it will be enough to sustain the economy in future, only time will tell. But there is no doubt they have achieved a remarkable turnaround.

Australia obviously needs to focus on the fundamentals of cost management in both its public and private sectors. It also needs to take a close look at its spending and savings patterns. For some time now the National has been consistent in its position on these matters. Let me repeat our position:

• Australia operates in a global marketplace. Its public and private-sector cost structures need to keep step with, and preferably improve on, those of similarly developed nations.

• The costs associated with commonwealth and state government rivalry, political correctness and excessive regulation need to be reduced to free up capital for more productive uses.

• Parallel with this cost-reduction drive, there needs to be a concerted effort to stimulate national savings.

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The main aim here is not a reduction in overall consumption, but redirection of funds into more productive, growth-stimulating investments. I believe there are signs that we are moving in the right direction. The government has signalled that it is serious about its deficit, with the stated aim of a Commonwealth budget surplus in two years through an $8 billion cost-reduction program and related measures.

State governments have embarked on cost-reduction and asset-sales programs designed to reduce their overall deficits. Victoria, for example, has turned a deficit of $1.7 billion in 1993 into a forecast surplus of $700 million for the financial year.

The overall current account deficit is also falling – although our forecasts show that one of the main factors is subdued domestic demand, which is not necessarily a positive trend.

There is also evidence that the Commonwealth government is seeking to reduce administrative duplication by consolidating key business regulatory agencies such as the Australian Securities Commission, the Insurance and Superannuation Commission and the Australian Competition and Consumer Commission within one ministry.

This is a positive move. However, it is not enough to just consolidate administration in the form of a so-called “super regulator”. If you are to consolidate regulators, you should also take the opportunity to critically review and rationalise the legislation and regulations they are to be responsible for.

We need to ensure legislation, regulations and the processes adopted by regulatory agencies keep pace with global economic change. An example here is competition policy. I obviously have a particular interest in this topic. The Hilmer Report and the emergence of the Australian Competition and Consumer Commission were important steps in microeconomic reform in Australia.

In the case of the banking and financial services sector, I believe there are matters that still need to be resolved. First, what is the appropriate definition of a market? I would argue that technology has totally redefined markets and competition in our industry. Today, any company with a sophisticated technology and communications platform and a broad customer base can successfully deliver a financial service.

Insurance, computer software and postal service companies are a few examples. A company with little technology and a limited customer base can also successfully deliver a financial service. Mortgage securitisers and home loan companies are examples. You can deliver services remotely by telephone and computer, or in person at branches.

The National Australia Bank does not compete solely with other banks. We compete with credit unions, building societies, mortgage originators, life offices, superannuation funds, telecommunications companies, post offices, debit and credit card providers – and the list goes on.

Today, the emphasis in our industry is on the retailing of financial services. We are not just banks, but the retailers of an integrated range of products and services for governments, organisations, businesses and individuals. Our focus is on technology-driven product development and distribution. We are also using technology to drive down our costs in order to remain competitive with global suppliers.

In such an environment, it seems implausible to argue that competition is a function of the number of particular types of service providers in an area as small as a state. Surely it’s a function of the number of services available at world competitive prices to consumers.

It is also a function of the barriers to entry to supplying a particular service. In our industry, those barriers have been dramatically lowered by technology and will continue to fall. Another issue related to competition policy in relation to our industry is the consistency of the objectives of the various regulators. For example, the Reserve Bank’s prudential requirements favour strong, financially sound banks with significant critical mass to guarantee their long-term ability to invest in the capital necessary to meet competitive challenges.

The Australian Competition and Consumer Commission, on the other hand, might have as a priority the need for a range of banks of varying sizes and financial strength with the aim of keeping prices low. The long-term impact of low prices and reduced surplus funds for reinvestment in necessary technology might not be a major consideration for the commission.

An additional complexity in the case of banks is that the price of its products in the form of interest rates are in fact a component of government economic policy. The Reserve Bank, for example, may want interest rates to rise as part of monetary policy. The commission, which now includes a prices surveillance role, presumably wants to keep prices low.

The key issue surely is what is in Australia’s long-term interests. And that is a matter that I believe is anomalous under present Australian competition policy. A merger of any of the major banks in Australia would apparently be automatically deemed by the commission to “substantially lessen competition”. The banks involved would then have to persuade it otherwise.

Why, given the clear evidence that banks are not the sole providers of banking and financial services, would it automatically be assumed that a reduction in the number of banks of any size would be “anti-competitive”? I wonder whether it is not time to have a more broadly based review of the principles underlying competition policy in Australia today – at least those relating to
the banking and financial services sector.

I believe the resolution of issues associated with competition policy and other regulations that influence investment and resource allocation are as important to the Australian economy today as the debates and subsequent changes we have seen in recent decades regarding tariff reform.

Resource allocation is also strongly influenced by policies relating to national savings. The savings habits of Australians are such that locally generated investment capital is a scarce resource. The share of household disposable income Australians save is a remarkably low 1.5%. Less than two decades ago we saved around 15%. We need to ensure we take every opportunity available to stimulate private savings and use of locally generated funds for business investment.

Once again, the National has been consistent in its view that we need to ensure matters such as the provision of superannuation products for individuals or the balance-sheet treatment of funds provided as equity loans for small and medium-sized businesses are not hampered by out-of-date legislation.

These matters should not be viewed as isolated issues. They ought to be viewed as part of a comprehensive effort to stimulate savings and reduce Australia’s current reliance on overseas-sourced investment capital. This in turn will have a beneficial impact on Australia’s overall economic performance.

Looking to the future, we believe the economy continues to experience a rougher ride than many have recognised. This is particularly the case in manufacturing, construction and the wholesale/retail sectors.

While there are signs that business confidence has improved following the federal election, business conditions have not. Forward orders continue to track down. While there has been improvement in stock reduction, excessive levels of stock remain.

We expect the overall performance of the economy to be patchy. There may be scope for a change in the current mix of fiscal/monetary policy. As long as the government remains committed to the fiscal measures of significantly reducing the commonwealth budget deficit, and other measures such as underlying inflation remain moderate, there may be an opportunity to vary monetary policy by lowering interest rates in the second half of this year.

When we come to consider the benefits that can flow from timely reviews and changes to legislation and regulation, the common economic agreement formulated by Australia and New Zealand in 1983 is a good example.

A high level of economic integration has been achieved. This includes the virtual elimination of tariffs on most trans-Tasman trade, the creation of a rules framework for services trade, a significant degree of labour mobility, a new double-taxation agreement and attempts to harmonise business law.

I believe there is still more that could be done to improve the rate of integration, particularly in the form of a formal agreement to assure free and open access across the Tasman for Australians and New Zealand companies.

Current impediments include:
• the lack of a transparent process for assessing foreign investment applications;
• dividend imputation arrangements in Australia and New Zealand that only allow tax credits on dividend income earned by local shareholders in companies considered to be locally owned;
• the fact that neither country allows an investor in the other country to claim an imputation credit for tax already paid on profits in the country where the investor is not resident.

In summary, both Australia and New Zealand are operating in an economic environment that is in a process of continual change.

The priorities of both nations are to have economic policy settings that encourage growth, stimulate appropriate resource allocation, and encourage investment that includes a significant amount of locally generated savings as a funding source.

In terms of the banking and financial services sector, it is obvious that the business is undergoing a radical transformation. Our response at the National is to see our business as having no boundaries. Nor is there any foreseeable limit to the number of our competitors.

The transformation involves every facet of the provision of financial services. It requires a mix of capital-intensive technology, a re-engineering of processes to ensure cost efficiency and a total customer focus.

Our aim is to improve on our current performance. As I noted earlier, whether it be cricket teams, companies or nations, you have to be equipped to compete against the best in the world.