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WHAT HAPPENED TO NEW BANKING COMPETITION?

THE FOUR MAJOR BANKS ARE CLEARLY THE DOMINANT FORCE IN RETAIL BANKING IN AUSTRALIA. DESPITE A LOT OF RHETORIC ABOUT NEW COMPETITION AND THE HIGHLY COMPETITIVE ENVIRONMENT, THE MAJORS HAVE CONTINUED WITH RECORD GROWTH, INCREASED THEIR RETURN FOR SHAREHOLDERS AND HAVE ENTRENCHED THEIR MARKET POSITION. BY BRYAN O'CONNELL.

The big banks' continued strength, coupled with tough market conditions, have weakened some of their competitors, particularly credit unions and building societies. These conditions have also made it harder for potential new entrants to consider entering the market and making a real difference once here.

The 1996 Wallis Report on the financial system was meant to have fostered a raft of new entrants such as retailers, telcos, utilities and other financial service entities. Few, in fact, have entered the banking market. For instance, where is the nation's biggest retailer, Coles Myer?

Mortgage originators did provide some fresh competition, but this was based on a very narrow product base of home loans, without any sustainable long-term business model. They were unable to sustain any price advantage, or introduce any other product offerings to complement the mortgage product so as to provide consumers with a wider alternate choice.

Regional banks have been very important in offering an alternative to the majors and their recent performances have been comparatively strong. Yet the strongest of those competitors, St George Bank, is under threat of takeover in July this year, when it loses protection under its articles of association.

A St George takeover – most likely by 10 per cent shareholder the National Australia Bank – would remove a major chunk of regional bank competition and an important alternative to the majors, particularly in New South Wales.

Whilst it is true that retail banking is highly competitive among existing players, it is questionable whether their dominance in

the future will come under any substantial threat, particularly in their core product areas.

This should not undermine the fact that the environment will continue to be very tough for the majors, who may struggle to maintain double digit growth and earnings.

However, as the last five years in particular have shown, the Big Four have simply got better at adapting their businesses and creating greater efficiencies. They have utilised their scale, they have mastered technology and also engaged more highly skilled people for their businesses. Significantly, they have also got better at learning from their past mistakes.

Where are the global competitors?

While it is unlikely for the time being that we will see a major international bank taking over a local major bank, the presence of some major global banks making inroads into the Australian market should not be discounted.

Two of these banks, ING and HSBC, are in the top ten of world banks and, in the longer term, could prove to be vital alternatives to the Big Four's hegemony. They will certainly add more choice for consumers and their global leverage and presence should keep many Australian banks on their toes.

ING

The Dutch-based ING Direct, part of the worldwide ING group, has developed a very public profile in Australia over the last two years. ING group is active in banking, insurance and asset management in 65 countries, with more than 100,000 employees. In its first decade, ING achieved a 16 fold increase



in market capitalisation, from 5 billion Euros in 1991 to more than 80 billion Euros at the end of 2000.

Many people would now be familiar with the ING name in Australia, thanks to prominent bill boards and the bank's ad campaign starring comedian Billy Connolly. ING, and in particular ING Direct, is starting to build a major brand in Australia, with its customer take up surprising even ING itself.

ING Direct started in Australia in August 1999 with a direct savings product. Today ING has some 235,000 customers and had a deposit base of more than \$5 billion as at the end of last year, 2001. The growth rate has not abated, with current figures showing a growth rate of 10,000 customers a month. These significant figures mean ING has created real competitive heat in the saving deposit market. Things could hot up even more once ING Direct introduces more products to the Australian market.

So what has been ING's approach and strategy so far in the Australian market?

ING head of direct banking Craig Kennedy says it's consistent with all the other direct operations the bank has launched globally.

"The intention is to enter into a mature market with direct banking as the means of distribution (no branches) and look to provide a high value savings product," he says.

"The reason that the savings product was chosen is that it is the easiest decision for a customer to make compared to a mortgage. In addition, a customer's transaction needs are very well catered for (by other banks) and thus the focus over the last two years has been to service savers, rather than transactors."

Early research indicated to ING Direct that people had little alternative. They thought one bank was very similar to another and if they had a problem and changed banks, they would have the same problem three months later. In addition, changing a transaction account is very difficult and people are reluctant to do it.

ING Direct has therefore worked to complement a customer's banking relationship and to satisfy aspects of their banking relationship that are not being met. This has been the differentiator that seems to have given the bank early success. New entrants need to offer something different to attract customers and ING Direct has done that.

Kennedy says the bank has remained focused on savings, because that is where it has a sustainable cost advantage which it shares with customers. "In our terms and conditions we have an assurance that we will never introduce fees," he says. "We have overcome the scepticism about our offering."

According to Kennedy, the bank is not only gaining 10,000 customers a month but is achieving a stronger flow of dollars from existing customers. The \$5 billion deposit base at the end of 2001 grew from \$2 billion in 2000. "That growth of \$3 billion dollars has far exceeded our expectations," he says.

Unlike many other direct banks that struggle to show profit, ING Direct expected to be in the black in 2001. "The normal model is that you have between three and four years to become profitable," he says.

"In Australia, we are 14 to 18 months ahead of schedule. Profitability is expected to increase for the next financial year as well."

Kennedy says ING is pursuing a market the majors are not that interested in. "We have made a deliberate attempt to attract individuals, rather than specifically focus on corporates or high net worth customers, where other banks have traditionally pursued deposit customers."

"That focus led a lot of people to warn of small balances and unprofitable accounts, but this has turned out not to be the case. Our average balance is in excess of \$23,000. This has been done without specifying a minimum balance and no fees."

The next stage for ING involves going back to the customer base and developing needs-based products. Over time, the bank intends to have a leading product in each category, rather than the majors' approach of providing a comprehensive range of products within each segment.

"We are going to continue with our focus on savings but have already launched a managed fund to our client base," he says. "Out of 100,000 customers we put an offer to, about 4700 have taken up the investment. This is an excellent cross sell rate based on the simple method we used."

ING Direct also plans to introduce a loan product but details are being held close to its corporate chest. But suffice to say it will involve a simple form of consumer finance based on direct distribution.

Kennedy warns that the real challenge is to grow cautiously in relation to introducing new products, especially given the pay back period for a new product is between two to three years.

"We want to remain profitable but also share our low costs for the benefit of our customers," he says. "Thus we are trying to strike that balance between growth versus profitability and that is a very important feature of our plan over the next couple of years."

HSBC

HSBC is another global banking monolith, ranked second in the world based on market capitalisation and the biggest bank in Europe. HSBC globally has \$1.4 trillion in assets, 29 million customers and operates 6500 branches in 78 countries. These are frightening stats for Australian banks to contemplate and the presence of HSBC in retail financial services in any country needs to be taken seriously.

While HSBC has operated in Australia for some time, its retail presence has only recently been felt through the opening of more branches and the acquisition of the NRMA Building Society.

Over the last five years, HSBC in Australia has grown on average at 30 per cent per annum. Today, HSBC has about \$6 billion in assets and liabilities and has 21 branches in major locations throughout Australia with a further two under construction.

HSBC (formerly known as HongKong and Shanghai Banking Corporation) changed direction globally in 1998, when its focus shifted from being a predominantly corporate bank. HSBC realised the growth in wealth management was going to be a major focus and this has had wide ramifications for the development of its retail banking business here.

HSBC, unlike ING Direct, has a full service banking proposition and directly competes with other retail banks, including the majors.

"We think of ourselves not as a foreign bank, but as an Australian bank that happens to have a foreign parent," says HSBC head of personal financial services Kevin Martin.

"That has been a big mindshift change. We are very much in the market to provide banking for Australians for the long term. That is why we have seven branches that are less than a year and a half old and we will double our branch network in the next five years."

According to Martin, HSBC's strategy is to give customers a choice of distribution. "One of the keys to this approach is that customers have access at all times to speak to a person if that is their choice and this is a key differentiator."

"When customers contact our call centre the customer will talk to a real person. We then ask our customers where they want to do their banking – in a branch, on the phone, over the internet or do they want someone to call around to their office?"

HSBC has a full range of products, including transaction accounts which compete with the majors' offerings. These include a fee-free online savings account which can be used via the phone or the internet and also can have a cheque book or ATM card attached.

HSBC is competing to a more limited extent through branches. The bank does not have – and will never have – the number and coverage of branches of the majors. Nor does it want to compete in every area in which the majors operate.

Like the majors, HSBC's branches are located in areas likely to attract high value customers and where customers want to deal with branches.

Interestingly, HSBC in the past has taken a conservative approach to using brokers; in fact the bank ruled out brokers for referral of business as a matter of policy until fairly recently. This has now changed, with the bank realising that brokers do play a part in a retail distribution network and can be a source of good business.

HSBC in Australia has established an infrastructure to provide 24-hour service which, Martin claims, the majors have not yet achieved.

To further show how serious it is about the Australian market, HSBC recently acquired the NRMA Building Society, rebranding it under the HSBC banner. According to Martin, synergy was

the key drivers behind the acquisition. "We have lots of capital, including people capital, a call centre, the internet and a global brand, but we did not have customer volume," he says.

"The building society had mobile lenders and a strong mortgage business, whereas HSBC in Australia has had a strong liability business. Thus we could blend the two skill sets and the balance sheets.

"What also suited us was that the building society did not have any branches and allowed HSBC to offer a number of services and products that building society customers were not offered."

Martin says the acquisition has brought forward HSBC's growth plans by five years. The bank is putting a line in the sand for the Big Four, he says.

"We want market share in Australia and are prepared to aggressively pursue our strategy," he says.

"At the same time, there is recognition that we do not have and will never have the branch infrastructure and the customer franchise that the majors have. But, on the other hand, anyone in Australia who wants a leading market product can access us through various other means, around the clock."

Conclusion

While the major banks look set to continue their dominance of banking in Australia, watch out for the global banks: ING Direct with niche products and HSBC with a full service option.

They are both growing rapidly – albeit from smaller customer bases – and offering alternative choice to Australian consumers. □



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