Global banks face growth challenges in uncertain world

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Global banks have experienced some major complexities and challenges over the past 12 months. With increasing turmoil in the world economy and financial markets, banks are facing new complications and continuing uncertainty as to what the future holds.

This uncertainty not only challenges the banks' capacity to maintain stable operations and profitability, but also to keep credit risks in check; it also has a major effect on how banks manage the growth of their business. In this new climate, banks must determine how to grab hold of the right opportunities for growth. They need to consider ways to:

- grow organically;
- get the right mix of business;
- shift the focus to higher profit segments of the market such as wealth management;
- approach consolidation and acquisitions (that is, cross-border or within the safety of known borders); and
- position themselves in emerging markets such as China.

Regional risk

No region is ever without risk. It has to be said, however, that certain regions are exposed to more risk than others.

In the past, global banks have paid a heavy price for regional risk; unstable economic and political conditions in Russia,parts of South America and South East Asia, for example, have been responsible for major losses to global banks. Worsening economic conditions worldwide — as well as security issues associated with terrorist strikes and the threat of war with Iraq — have exacerbated existing problems. These factors all amount to many more sleepless nights for CEOs trying to find safer paths and steer their banks in the right direction.

Clearly, many of these issues call for new modes of strategic thinking at the top levels. Banks will need to determine how to:

- properly assess the impact of these risks;
- react quickly to political events that create instability and changing economic conditions;
- assess and fundamentally reduce credit risk; and
- respond to the changing demands of management.

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Troubled regions

Regional banking concerns continue in a number of trouble spots around the world.

In Japan, there is ongoing uncertainty about how the government will support the banking system, and concern about the financial stability of some banks. While some recovery has been made across South East Asia since the 1997 currency crisis — for instance, there are new positive signs for banks in South Korea — rebuilding economies has been a slow process and many Asian banks are still struggling to get back on track. In addition, new concerns are arising over the effect of increased terrorism within the region, Indonesia in particular being vulnerable.

In South America, there are ongoing critical default problems in Argentina, and now pressure on Brazil's financial stability is raising concerns that a restructure of the country's debt may become inevitable.

There are new and emerging regional problems in the centre of Western Europe. Germany, which in the past has been such a powerhouse in banking, is now facing trouble. Serious issues are being raised about the financial performance of some of the country's major private banks and the effect that it may have on the region. Deutsche Bank, in a report released in July 2002, stated that declining asset quality and poor profitability have resulted in selective downgrades of banks, reflecting difficulties in achieving cost efficiencies, competitive pressure and the erosion of traditional customer relationships.

These factors coupled with the poor state of the economy, suggest that there is a need for many of these banks to address a number of fundamental problems that they have — these include extremely high cost structures, thin margins, weakening franchises and poor equity returns; they have also suffered from a failure to expand into new markets, such as consumer finance where foreign competitors such as Citibank are taking advantage of market opportunities.

Political and event risk

Since September 11, political and event risk has emerged as a major agenda item for bank CEOs in their approach to risk, strategy and the well being of their customers. This has created a new challenge for the executive leadership of global banks, particularly their focus on operational resilience. This is the ability of systems, resources and processes to support a business under a sudden adverse event or unexpected condition.

Global market confidence

We have seen global markets take heavy knocks, which have hit investor confidence.

A major blow were the problems that began with the collapse of Enron, followed closely by Worldcom. As the Bank for International Settlements noted in its September 2002 report, the fear of more widespread corporate problems precipitated a slump in equity markets in both the US and Europe. This spilled over into the once resilient corporate bond market, where issuance slowed as credit spreads widened. These events followed the global downward spiral of private wealth in 2001.

Credit quality

Falling credit quality remains a major issue for global banks — Standard & Poors lists Rabobank as the only remaining major global bank with a AAA rating. This is compounded by ongoing consolidation in banking markets across the world. There are fewer banks and therefore fewer counterparties than five years ago.

This creates a challenging environment in which banks must attempt to maintain credit quality and spread risk.

Maintaining the fundamentals

While the above are the more critical risk concerns, there is another set of challenges facing global banks. Some of these are how to:

- maintain key balance sheet fundamentals;
- establish the right mix of business;
- use scale to maximise product and service advantages in new markets; and
- transform successful platforms from established markets into other new markets.

In general, banks must develop innovative strategies to capture growth opportunities, not only in established markets, but also new and emerging markets.

Regional prospects

Notwithstanding the regions of high risk, many other parts of the world offer stability and profitable banking for global banks. Credit ratings are reasonably stable and good prospects for growth opportunities are mixed with tough competitive conditions and increasing consolidation.

A number of countries in Europe and other parts of the world have these characteristics.

In the Netherlands, for instance, ING, ABN-AMRO and Rabobank dominate the domestic market and have also been very successful with aggressive expansion outside their home environment.

In France, profitability of banks has been improving and return on equity is moving to more acceptable standards in line with better economic conditions. France's largest global bank, BNP Paribas, has shown improving financial condition and better profit orientated culture. It has also had major geographic diversification and established important international networks. It now has a presence in 87 countries.

In the UK, banks generally continue to show good profitability in a very tough competitive market. However, there has been significant consolidation both by domestic institutions and foreign players. Foreign banks now dominate investment banking and UK retail banks could be vulnerable to take over by foreign interests. In terms of growth, many larger UK banks face the challenge of how to expand their businesses and create new opportunities. With the exception of HSBC, we have yet to see any 'major acquisitions' of European banks by UK banks.

Meanwhile, China's banking system faces massive modernisation and transformation challenges — the Bank of China has something like 100 million individual accounts and approximately 20,000 branches. Global banks are actively seeking to capture opportunities but may be faced with major problems in trying to break the Chinese market. While existing global banks like Citibank and HSBC seem well positioned, there are issues to be addressed regarding what foreign banks really expect from China and what the risks are.

Performance of Australian banks

Australian banks have shown very strong financial performance over the last five years. The National Australia Bank has just announced a profit of $3.7 billion dollars, while other major banks ANZ and Westpac have now shot over the $2 billion profit mark. Australian banks have moved to world's best practice in terms of cost/income ratios, with ANZ now an enviable 45.5 per cent. Returns on equity are also extremely robust at or near 20 per cent. NAB remains intent on its global operation strategy with its focus on the UK, but other banks such as ANZ, which recently disposed of its global operations Gridlays to Standard Chartered, remain focused on the domestic market.

Conclusion

In summary, all these issues are posing a new and challenging environment for global banks to safely manage and grow their business. At the same time, banks need to deal with the inherent risks that come with the business of global banking. ●

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New Zealand Consumer Credit Bill

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The New Zealand Government has introduced the new Consumer Credit Bill. The Bill is designed to replace the existing *Credit Contracts Act 1981* (NZ) and the *Hire Purchase Act 1971* (NZ) both of which apply equally to consumers and non-consumers, including corporations.

The reason for the change is that the Government is of the view that the existing consumer protection provisions and disclosure requirements do not adequately protect consumers. The Bill contains provisions which are similar to the Australian Consumer Credit Code. The Bill is to be referred to a select committee. No date or time has been set down for submissions and hearings.

The main features of the Bill are as follows.

- It applies to consumers only — business and investment credit is excluded.
- It imposes limits on credit and related fees. Credit fees, charges, default charges, early termination fees and so on are limited to those that are reasonable or reasonably incurred. There will also be restrictions on the accrual of interest.
- Disclosure requirements have been simplified in the sense that there will no longer be a duplication of some requirements as is the current position with hire purchase and loans. The need to disclose the finance rate will be done away with, as will the need to disclose the total cost of credit.
- The penalties regime has been beefed up substantially with the imposition of increased statutory penalties. The powers include banning financiers from lending.
- The statutory cooling off period remains but all consumers will have a three day period to reconsider their credit contract.
- The Commerce Commission is to be introduced as a policeman and teacher/educator. It will be able to bring proceedings to enforce the civil penalty provisions in place of debtors. Currently, only a debtor can do this.
- The enforcement provisions highlight the importance of lenders ensuring that they have adequate compliance plans and staff training regimes. The courts will be empowered to take these matters into account when considering civil penalties.
- Remedies for oppressive conduct will apply to all lending irrespective of purpose.
- The legislation will apply to consumer credit contracts as defined and also to consumer leases.
- Consumer contracts mean those entered into primarily for personal, domestic or household purposes.

The application of the Bill to 'consumer' transactions as defined will bring New Zealand credit laws into line with Australian laws and with international convention. ●

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