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Speech Notes

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I'm delighted to be here today talking about a subject I am still extremely passionate about after eight years – Bank of Queensland.

And it's very fortunate that I love talking about BOQ because in the last two months I have had more invitations to speak than in the six months prior, and I don't for a moment believe it's because of my witty repartee or my dulcet tones. It's because we are in unprecedented times in terms of the global economy and its impact on the banking industry and people want to understand what's happening and where we're going.

The good news is I have forty years of banking experience I can call on; the bad news is I have no crystal ball.

The past six months have been unlike any in my career. We have seen major international banks collapse, government bail-out packages, and economy after economy slide towards recession.

In fact, we are seeing a global financial crisis unlike any we have seen since World War 2.

And while, unlike Doug McTaggart, I don't have a crystal ball to be able to tell you what will happen next, I can certainly give you my thoughts on what has happened to date.

I don't believe the Global Financial Crisis was the result of one specific incident, or issue. It was a combination of factors that created a snowball effect in terms of the American economy, and then like a particularly nasty virus, its impact spread quickly to all of the economies America has dealt with. Which is to say, almost every economy in the world.

One of the underlying factors was people leveraging themselves to the hilt as they tried to amass wealth at the height of the stock market boom. Some refer to this as greed!

Another factor was the watering down of risk procedures and lending standards as companies became complacent in the wake of an extended boom period.

And on the issue of risk, innovation in the financial sector grew at such a rate that financial institutions and regulators were unable to understand, let alone manage, the level of risk being taken on.

The results have been far-reaching and widespread. Massive financial powerhouses including Merrill Lynch, RBS, AIG, HBOS, Bear Sterns, and Lehmans, among many others, have either failed or required bailing out. As I said earlier – an absolutely unprecedented series of collapses unlike anything I have seen in my 40 years of banking.

But what does this mean to Australia?

The good news is that the Australian banking system is far more stable than our overseas counterparts. And this comes down to a number of factors.

Firstly our regulatory framework has proven to be one of the most effective in the world. We are far more conservative in our approach to risk than many of our US counterparts.

We also tie the re-payment of mortgages to the borrower, not just the house, which meant we didn't see the 'jingle mail' that happened in the US where home-owners simply mailed their house keys to the bank when they couldn't keep up with the mortgage – or burnt their houses down rather than hand them over to the banks.

And we didn't undertake the kind of sub prime housing lending that was one of the initial landslides in the earthquake that became the GFC.

The conversion of mortgage securities from huge, illiquid assets owned by local banks into liquid financial instruments that could be sold across the world combined sophisticated U.S. financial services dangerously with relatively unsophisticated financial services elsewhere.

The sub prime lending and the 'jingle mail' phenomenon, combined with an excess supply of housing, were a toxic combination that set the credit crunch in motion.

And I'm delighted to say we don't have these three factors here.

Essentially, we are in a much better place than the banking systems off-shore.

But it's obvious that the Australian banking industry has been impacted by the GFC. A quick scan will show that consolidation in the industry has reduced the number of regional banks to three, if you include our big Queensland cousin as a regional bank, with almost constant speculation that all three are about to be bought out or taken over.

For my money I don't believe the current Federal Government is all that worried about that prospect.

In a marketplace where the funding costs are higher for regional banks than for the four majors, the government are now charging regional banks more for their wholesale funding guarantee.

I can't see how it can be anything other than anti-competitive to sting the regional banks more for the funding guarantee when they are already paying more for their funding. It has created a very uneven playing field, making it difficult for regional banks like BOQ to build shareholder value and at the same time remain a competitive alternative in the marketplace.

In a recent speech about the future of Australian banking, David Morgan, the former Westpac CEO, indicated that any stand alone financial institution with a credit rating much below AA will, at best, struggle to obtain funding on a cost competitive basis with the Australian majors.

And he's right.

What he also mentions is that the second tier of financial institutions in Australia is fast-disappearing, rapidly becoming an extinct species.

What he doesn't mention is that this doesn't seem to bother the Federal Government.

To my way of thinking the last issue on the Government's agenda is competition in the Australian banking system. They want stability for the 'big four' and in my view don't really care if the rest of the banking players disappear.

From my perspective the Federal Government's interventions on that Sunday in October last year were both timely and necessary and potentially avoided a major financial crisis here in Australia. However the initiatives also had the effect of distorting our competitive banking system, particularly in the area of wholesale funding. I think now is the time to reassess some of these initiatives in order to remove the distortions created.

Anyway, let me get back to the Big Four.

A number of economists and business commentators have suggested that the Big Four will actually prosper from the banking crisis, as a result of reduced competition, increased market share and enhanced pricing power.

I agree with these suggestions.

Look at the foreign players in our marketplace. Most have either packed their bags and gone home or significantly downsized their scope of activities in Australia. Non bank lenders such as Wizard and Rams have either disappeared or been taken over. Even “we'll keep 'em honest John” has taken refuge in the bosom of one of the Big Four.

In fact, I don't see how the Big Four can anything but benefit from the situation we are currently in. And I'm confident they believe it is only a matter of time before the name Bank of Queensland ceases to exist in Australian banking.

So let me assure you that it is my very clear intention to ensure that doesn't happen.

It is my intention to ensure that BOQ continues to be a real alternative to the 'big 4' in Australia.

We still want to be a 'big small bank', and not a 'small big bank'. We still want to offer Australian consumers, and shareholders, an alternative in banking.

But before I talk more about where we're headed, let me take you back seven years, to when I joined BOQ as Managing Director.

Back in 2001, BOQ was doing OK. It wasn't a sinking ship, but it certainly wasn't outperforming or in fact performing anywhere near its potential.

We had one of the most identifiable brands in the State yet less than 6% of Queenslanders actually banked with us. And our branch network was smaller than any other bank's despite the fact we were only in Queensland.

At the time I had many asking why I would I leave a senior position in a major bank I had been with for more than 30 years for the challenges which Bank of Queensland offered in 2001. It came down to one word – potential.

Bank of Queensland had enormous untapped potential, and still does in my opinion. I understood that there was a very solid base there, but I also knew that if we kept doing what we'd always done, we would never move forward.

In fact, there is a great quote by Wayne Bennett in his book 'Don't die with the music in you' which says "If you do what you always did, you'll get what you always got", which I think sums it up perfectly.

So, given the need for change, there were a number of paths I could have taken as a new Managing Director and CEO.

One was the tried and true path of new, but short-sighted, CEOs – slash and burn. Blame everything on the last guy, cut costs, and become a darling of the market through increased profit.

Usually when a banker talks about cutting costs it comes down to shutting branches and sacking staff. That is what is often expected of an incoming new executive in today's tough world of corporate business. After all, a low cost-to-income ratio means a happy market.

Or, I could take the other safe path of slowly building on the strengths BOQ had in the market, looking to leverage off a well-known brand through low-risk growth strategies which, while not as spectacular, would still have built value.

It means an easy story to tell the market, and analysts can build a standard model in which to place Bank of Queensland.

Or I could take a more radical, riskier path. Well-managed risk combined with perseverance could perhaps win the day.

What if we built shareholder value through dramatically increasing revenue?

What if we built value through cutting costs without cutting people?

What if we came up with a new way to do banking in Australia, rather than following the pack?

Would we have the courage to see that new way through, even though it would be so different from the way the rest of the banking sector was doing it, and given it may be a while before others see the benefit?

Luckily I had a board of directors who accepted the vision, and a new executive team who were able to drive the changes.

We had confidence in our vision, and belief in our ability to execute it, but there were some dark days as we put up with the scepticism of the analysts, media and our competitors.

At one stage our largest shareholder, the Commonwealth Bank, sold its 11 per cent stake overnight and without any warning, driving our share price from what was then a high of $11 down to about $9.30.

This was a huge dive at the time but remarkably, in the economic crisis we are living through, it will be a good day when we hit $9.30 again.

But despite CBA dumping our stock, we stuck to our guns.

On another occasion Australia's most senior banking analyst said the BOQ model would not work, but we persisted and continued to push on.

And when our plan to replace our entire core banking IT platform created some heartache amongst our customers, many in the industry smirked quietly behind their hands and talked of our inability to manage our growth.

And even when we bought a couple of companies, one in ATMs and another in equipment finance, there was the claim that we had no integration experience and that the purchases could prove to be costly duds.

And then, when we announced that we would spread the BOQ story interstate, there were the claims that the brand would never work, and that the model was somehow distinctly Queensland, and couldn't possibly translate to the more sophisticated markets of Sydney and Melbourne.

Our competitor banks, which are all larger than us by the way, went on, often patronising our novel attempt to bring personal service and branch banking back to Australians.

While we undertook to open branches rather than close them, to drive more employment rather than less, our results showed a marked improvement.

So how did we drive this growth? We looked outside the square. We innovated. We looked at the Australian banking industry, at Bank of Queensland, and at successful banks across the world and we came up with an innovative new model that we knew would work.

In 2001 we had 93 branches, in Queensland only, of which 35 were an agency model. Now, these agencies looked exactly the same as the corporate-owned branches, and provided full banking services.

The problem for the Bank was that these agencies had little incentive to actually drive value for the bank as they were remunerated on a transaction rather than a sales basis.

Having studied the banking system in America, I had, when I came to BOQ, a different idea of branch banking from many of my contemporaries.

In the US the branch was making a big comeback as a retail outlet, a viable sales channel, instead of the Australian perception of a branch by the big banks as a drain on profitability.

US banks were opening hundreds of new branches across the country, expanding their footprint and opening themselves up to literally millions of new customers.

Here in Australia, the banks were still closing branches.

I thought a small bank like BOQ could make its mark by being different, but, being small, we still faced issues around how to pay for a fast branch roll-out while also continuing to reduce our cost-to-income. The answer was the Owner-Managed Branch, or OMB.

What we did was turn our agency model on its head, and at the same time, turned Australian banking on its head.

We turned the tired-old agency model into a thriving, value-driving machine by changing it into a franchise model, and attracting the very best banking entrepreneurs to come on board.

Rolling out a bank branch franchise network is unique to Bank of Queensland in Australia, and our model is actually unique in the world.

With our OMB model, we have created a very different culture, a franchise culture supported by rigorous banking controls.

Branch managers were now rewarded on performance – for increasing both lending and deposits – as well as for providing excellent service.

And we quickly discovered that as soon as people had 'skin in the game' their attitude and performance changed.

What we have seen is a service-driven model in which the bank branch managers bent over backwards to find out what their customers wanted, and then provide it.

It also led to an influx of brilliant bankers from our competitors and unearthed some serious talent from within our own ranks.

The bankers who migrated from other banks had, for many years, been top performers, but were often frustrated by their inability to build strong retail relationships with their clients.

Whenever they performed well as a branch manager, they were inevitably transferred somewhere else. Whenever they built up strong a client base in business or private banking, those clients were then shuffled off to call centres or to another banker.

The problem was that they had nowhere to go, except to another bank where the same problems would eventually occur.

They were actually becoming victims themselves of some of the problems that had been facing their customers over the previous decade as banks forgot that they were in a service industry.

As Mark Twain once said:
“A banker is a fellow who lends you his umbrella when the sun is shining, but wants it back the minute it begins to rain.”

Now their big bank employers were demanding the customers’ umbrellas back and they, the bank employees, were on the end of a wave of righteous customer anger.

Their options were to stick it out, leave the finance industry completely, or take up as a mortgage broker which then, and still today, is relatively easy to do regardless of your competence. Many found the idea of leaving a full banking environment to sell a single product less than appealing.

They also knew that if they could combine their expertise in banking with a business plan that allowed them to share in the profits, they could really build their wealth.

That's where Bank of Queensland came in.

Our owner-managed branch model allowed these bankers to run a full-service branch with all the supporting bells and whistles, but in an old-fashioned, customer-facing, service-orientated way.

Consequently, we were flooded with offers by bankers in Queensland, and around the country, to take up the challenge of becoming a BOQ owner-manager. And in the majority, we picked only the very best of them, although the odd oxygen stealer managed to slip through our selection process.

The success of the roll out of owner-managed branches in Queensland through the variable cost model we developed, and the speed at which we were able to undertake the roll out, soon had us looking for new markets.

My plan all along was to ensure we attained the required reach and depth in the Queensland market. At 166 branches, we now match or exceed almost all the other banks' Queensland branch presence. We have opened franchised branches in NSW, ACT, Victoria, Tasmania, WA and South Australia, since beginning the roll-out seven years ago. We now have a total network of 283 branches.

We have obviously made some mistakes along the way, but we have learnt from these mistakes and have improved the way we manage our OMB network. And the results really do speak for themselves. We continue to outperform the market, growing at twice the pace of our peers in both lending and deposits, which is a significant achievement and is due in large part to our unique OMB model.

At the same time we were rolling out new branches, we were also opening new business banking centres, which have seen us return face-to-face banking to people running small and medium sized business.

So, innovation has driven our success, our resurgence as a company, and our emergence as a confident, stand-alone regional bank in one of the country's most competitive industries.

But all this wouldn't have been possible without the ability to actually execute our plans.

And so I will speak briefly on execution, and how vital it is.

As the old military axiom goes, no plan survives contact with the enemy, and so it is true that in business your plan is only as good as its implementation, or execution.

In Bank of Queensland's case, it didn't matter how revolutionary, how innovative we were, we had to make our plans, our vision, work. As they say, strategy's easy, it's the execution that's hard.

It is actually the part of the most recent BOQ story of which I am most proud.

As I alluded to earlier, before we began our Owner-Managed Branch rollout, many in the industry either did not realise we existed, or had quietly written us off as a force in banking.

It was one thing to come up with the OMB model, to realise we needed to dramatically improve business banking and expand in to areas like debtor finance, introduce a new computer system, upgrade our ATMs, revamp our entire product suite – it was another thing to actually achieve the results we expected.

Not what others expected, but what we expected. The expectations of others were fairly low initially, now they are much, much higher.

So, to bring together a small team, inspire that team with the vision and the mission, and to see the results has been deeply gratifying.

As full franchised bank branches had never been done before in Australia, we had to learn the execution side as well.

I believe the key is to never forget your goal, the end game. Never let the details get in the way of the overall vision.

And don't form too many committees – that's particularly important. Sometimes the best committee is one person! Ask my Executive Team!

While we have had many overseas financial gurus ask us about our model, and whether it can be transported into an overseas market, the hardest thing for us to explain is that it is more than just the model.

It is knowing what works and what doesn't. It is knowing who will work, and who won't, in a franchised bank branch.

Franchising can be a tough game if you are selling fruit juice or sandwiches. It can be an even tougher game when you must be a talented banker as well as someone with the skills necessary to run a small business.

It limits the pool available. If you then take the uncompromising stance we have taken, it limits it even further.

As I mentioned earlier, we also aggressively grew our business banking operation, focusing on providing small and medium businesses with a level of personal service not available at other banks.

This strategy, in tandem with the opening of 16 dedicated Business Banking Centres throughout Australia and two strategic acquisitions — equipment finance company UFJ Finance Australia in 2004 and debtor finance company ORIX Capital in 2005 — saw us double our business banking portfolio in just two years.

Using the experience and hitting power gained by these highly successful acquisitions, we purchased Queensland-based Pioneer Permanent Building Society in late 2006.

And in December 2007 we acquired Home Building Society in WA giving the Bank another 29 branches based in Perth.

Despite our earlier success with UFJ and ORIX, the nay-sayers doubted our acquisitional experience.

But you know what they say – success is the best revenge – and due to the dedication of my team, and our ability to never lose sight of the end goal, the vision, we have successfully integrated Pioneer and Home Building Societies.

Now this has all been a very positive story.

It has certainly been a success for BOQ, but as I touched on at the beginning of my presentation, the economic environment we're operating in has changed.

And while the banking industry is faring better than some of our offshore counterparts, there's no doubt we are facing a downturn.

But I have full confidence that we will survive this downturn, but that we will actually come out of it well-positioned in the new banking landscape.

Why am I so confident? Well in part, due to our OMB Model.

With some exceptions, specifically in New South Wales, the OMB Model has shown its resilience over the past twelve months as we have tweaked the commission structure to re-focus our franchisees on growing retail deposits, given the increased costs of funding. The result was a 24.7% % jump in retail deposits.

In addition, our conservative approach to commercial lending has stood us in good stead in these difficult times.

We don't have the exposure to the high risk corporate lending that our competitors do, and our impaired assets and 90 days-past-due results continue to demonstrate the relatively higher asset quality of our book.

At our half-year results next month we expect to report a more than a 25% normalised cash profit increase, which is a pretty positive story in this difficult market.

However, while I do believe we have done everything right in terms of where we're positioned in the current economic downturn, we still need to look at the way we do business.

We need to re-assess everything we do – do we need to do that, could we do it better, can we streamline that process, drive more efficiencies? And that's exactly what we're doing with Project Pathways – a major internal and external business review process we announced in December last year.

We wanted to take advantage of opportunities created by the global financial crisis, and so we decided to manage the situation, rather than letting it dictate our future strategy.

So we are looking both internally and externally at the options available to us, at everything from strategic partnerships, to complementary merger opportunities, and internally at portfolio optimisation and efficiency initiatives.

We have already made some real headway in this area with our efficiency initiatives, and many of you would have read in the press about the restructure we are going through at the moment.

This was something we had tried to avoid but like all organisations, we need to adapt to the changing environment and the stage of the economic cycle we're in.

We will be providing a full update to the market at our half-year results next month regarding our progress with the restructure, our portfolio optimisation initiatives, as well as what we can share in relation to our external merger and alliance discussions, and I am confident the market will respond positively.

Our focus remains on building shareholder value, and we have to think outside the square to do so in the current economic environment.

We have come a long way since 2001; we have grown from a small Queensland-based company with limited market share and a virtual unknown outside its home state to a national player, listed in the ASX Top 100 and a real contender in the Australian banking industry. And the story's not over just yet.

Thank you.