

## AIBF Industry Forum 2005 – CEO Forum

**March 23, 2005**

### **Speech Notes**

**David Liddy - FAIBF**

**Managing Director**

Ladies and gentlemen

Before I begin, let me say that I would like to have had a powerpoint presentation here today outlining some of the latest financial data from Bank of Queensland but, as we are two weeks away from our interim results announcement, that is not possible.

Instead, I will take up the challenge of the title I have been given for this speech – “Bounding Distance” – and try and talk about why there is still a place for the smaller banks in the Australian banking sector.

I say this at a time when the industry in Australia, I believe, is about to enter its most competitive phase ever. Yes, ever.

While government policy artificially maintains the four pillars policy, and overseas endeavours have proved less than fruitful, we now have our four major banks, and four of the largest companies in Australia, focused on the domestic economy.

Of course, there are the Super-Regionals in St George and Suncorp.

Add to this the thriving smaller regional banks like Bank of Queensland, Bendigo Bank and Adelaide Bank, and you have a pretty competitive industry.

On top of that, let's throw in some Aussie Home Loans, Mortgage Choice and other major mortgage brokers.

Then there's the resurgent BankWest under its new owners, HBOS, and the booming Wizard under its new owners GE, the largest corporation in the world.

Top off with Macquarie, HSBC, a myriad of building societies and credit unions and the growing online powers of the INGs, and you see what I mean.

Place this in a bowl, stir and toss in a slowing housing market and rising interest rates.

The recipe could cause some heartburn in the years ahead.

The fact is it's the big four which face the biggest pressure on the domestic market because they are so dominant, and that is why competition is so fierce at the moment.

Regional banks like BOQ have a lot of blue sky ahead. While the uninformed believe we are reliant on the housing industry, 40 per cent of our loans under management are business and commercial.

The true blue sky for the smaller players like Bank of Queensland is that, until last year, we were confined to one State.

While the economy may slow, we are taking an increasingly large bite out of the market with every new branch, every new town and every new suburb we enter.

And we have learnt from some of the mistakes the banking industry has made in the past.

As many of you would know, while I am quick to promote the efforts of Bank of Queensland and its points of differentiation, I am more hesitant to criticise my big bank competitors for their past mistakes.

Why, you ask? Well, I worked for one of the majors for 33 years, so, for one thing, it would be hypocritical.

And secondly, I was there when the big banks made the decisions they did, faced with the options they had, and their belief in what the future would hold.

I now readily admit that some of the decisions the majors made at that time were wrong, but they were still understandable.

Remember how many people jumped on the new paradigm of the technological revolution?

Remember how many people believed every market place would now be run via the internet, how shopping centres and video stores would be dead, and how such things as virtual, vertical market places would replace good, old-fashioned doing business?

Remember how no-one would ever want to go into a branch again because online banking, ATMs and EFTPOS would replace the branch because customers would no longer be bothered standing in queues or dealing with humans?

Remember how business would buy commoditised products and be managed through call centres because the internet would replace the old-fashioned business banker?

Well, I remember.

The problem with the industry was not that we believed these things initially, because everyone in the world did, at least until the so-called tech-wreck.

The problem for Australian banks came when they failed to realise that they were wrong.

Customers did want electronic banking, phone banking, ATMs on every corner, EFTPOS from every counter....

But they also still wanted good, old-fashioned, personal service.

When it comes to the biggest decisions of their lives, buying their first car, their home, that overseas holiday, they, more often than not, still wanted a human being to talk to about it.

While many in the banking industry saw the writing on the wall, many more believed that the customers would eventually come around and realise the wonderful advantages the banking sector had given them.

They didn't, and they still haven't.

When I joined Bank of Queensland in April 2001, we had some clear choices ahead of us.

Thankfully, having briefly worked in the USA some years ago, I had stayed in touch with their industry, and seen some early trends.

While the US banking market is very different from Australia, there were some customer service trends which were worth looking at in 2001.

A key one was the return of new branch growth, particularly in the so-called state-based, regional challengers. While the larger end of town merged to extend their network, these banks like CommerceBank were opening branches – lots and lots of branches.

They were not franchises, but they focused on a retail-style delivery of services, empowerment of staff, and based it all on customer-friendly, customer-focused delivery.

This was the opposite of where Australian banking had been heading for two decades, but it made sense to me, and it seemed applicable to Bank of Queensland.

At Bank of Queensland when I joined in 2001 we had 35 of our 90-odd branches based on an old agency model.

Looking at how strongly these challenger US banks were using their branches as sales channels inspired me to look at Bank of Queensland's branches in the same way.

Why should a branch just be a drag on costs? Why couldn't a branch be a positive contributor to shareholder value?

Does a new CEO always have to cut staff, slash expenses and close branches to prove he or she has what it takes?

Why not cut costs through more efficiencies instead of shedding staff? Why not open branches and expand the footprint into new areas, new markets and new customers instead of closing them down and retreating behind internet banking and ATMs?

Bank of Queensland may be 130 years old, but we are a challenger organisation, and, for many of you the first time you may have heard of us would be in the last couple of years.

We were Australia's smallest Bank, and we were confined entirely to Queensland with our business.

And even there, we were under-represented. We only had 90-odd branches compared to an average of about 140 of the other Banks. Our business banking was virtually non-existent, our ATM fleet was 25-years-old and our technology was state of the arc – A.R.K.

We didn't have internet or phone banking, or even a credit scoring system.

We had a great reputation, and a pretty good brand, but fewer than six per cent of Queenslanders banked with us.

We lived in the fastest growing SME market in the country, but had no dedicated resources or strategy on how to tap into this booming sector.

Clearly we were underperforming our potential. So, there were a few challenges ahead, but many opportunities.

But we are a challenger organisation, or at least we are now.

So we are used to challenges. In fact, we go looking for them. After all, it is the only way we will survive and thrive in the ultra-competitive world of the finance sector in Australia.

Over the last four years, we have undertaken a great many challenges. We have replaced our entire core banking computer system, and let me tell you that's not something you want to do more than once a generation.

We have tackled our under-representation in Queensland by growing to the 140-odd average of the other banks.

This gave us a market share in new home lending of 14 per cent, up from less than 6 per cent four years ago.

We then decided to go on another different path from the big banks and have more personal business bankers rather than a call centre.

We gave the business bankers and the branches key business areas to pursue, and then helped them do it.

One of these was the SME market, which we were perfectly geared up for through our entrepreneurial franchisee branch managers and our personal business bankers – to things they were not getting from their current bank.

Here we also stepped in and picked up an equipment leasing company called UFJ Australia which gave us 30,000 small business clients across Australia and a business which we have grown by 55 per cent in 18 months.

This success in our Queensland market in both the retail housing and deposit sectors, and the business sector, allowed us to make one of the biggest decisions in the bank's history – to expand interstate.

This is where I, as a former South Australian who worked in Sydney most of my career, often get the claim well, you know Queensland's different. Just because it works up there doesn't mean it will work here.

Well, yes, Queenslanders are different, in a good way, but they're not aliens.

I mean, if we deduce that this strategy is largely brand proof and that it is more a case of execution and getting the right people, why should it not work in Haymarket or Moonee Ponds?

The answer is, of course, it should, will and does work just as well interstate as it does in Queensland.

And, despite the nervousness some of us had about how Bank of Queensland as a name would perform interstate, we are carving out a legitimate presence.

This is not some toe in the water approach. We plan on having at least 100 new interstate branches in New South Wales, Victoria and the ACT by August 2006 – that's less than 18 months away.

Essentially we are opening one branch per week for the next 18 months – probably the biggest retail distribution expansion in Australia – let alone in banking!

We have already opened 21, announced that we will have 28 within a couple of months, and we are on track to hit our target of 100 interstate branches by August 2006.

The true success of this model is its simplicity.

Many bankers are unhappy with the way their industry has gone and their lack of personal contact with the customer.

Many bankers would like to be their own boss and run their own business but would find becoming a mortgage broker unfulfilling because that is only one part of banking.

And so, there is a strong market out there for potential Bank of Queensland franchisees, or owner managers as we call them. We knock back about nine in every 10 people who apply.

We then take this newly enthused franchisee for Bank of Queensland, and we place him or her (and half of our Victorian Owner Managers, for example, are women) into a branch in a town, suburb or CBD area which they know well.

They then know the area, know the customers, know the local business, and know their market. They suffer none of the normal disadvantages of an interstate business moving into a new market because for them, it is not a new market.

We call it the "street corner strategy" which focuses on understanding and managing local markets with local people.

We split profit with them, they take the up-front cost of setting up the branch and employing the staff.

It is a very good partnership.

The customers get local and continuous contact with an experienced branch manager who knows their needs.

We get local understanding of market conditions, a variable-cost entry into the market, and a shopfront in which to sell our very competitive and extensive product range.

The great news is, as a superior distributor of financial services and products, we don't even have to manufacture them.

Our insurance products, for example, are branded BOQ but built and supported by Vero and St Andrews.

And we are close to finalising similar partners for the manufacture of wealth management products.

We are sticking to our core competence – distribution!

Because, after all this rebirth and reinvigoration, Bank of Queensland is now a very good distributor of financial service products.

As you can tell, I am pretty positive about the future. However, I want to take the opportunity, while in this group, to also talk about some of the challenges facing us.

Challenges like: Is legislative change and imposed regulation about protection of the consumer, or just a perception that the consumer is being protected?

I know it's a question many in this room have asked over the last few years, at least amongst themselves.

After all, has anyone read every page of the average product disclosure document, or PDS?

It is like the old freedom "from" information joke. When someone requests information from the government and is given thousands of pages to sift through in a small room in an hour. The truth is in there, I'm sure.

The end result is ignorance. The end result is not transparency, it is not consumer protection. It is bureaucrat protection, it is politician protection.

When the cry is raised: "Why weren't we protected from the possibility of this happening to us?" the politician and the bureaucrat can point at the pile of product disclosure documents, privacy agreements, and international accounting regulations and say "look, we protected you."

For me the answer is simple. Rather than hundreds of pages, why not one page?

After all, customers now have a lot of protection. Privacy Act, Financial Services Regulation, IFSR, Basel II, the list goes on and on.

Why not make it simpler, rather than prohibitively complex.

Now, before anyone claims I am bashing the regulators or taking some sort of political stance, I am doing neither.

The regulators have a tough job, and are often the meat in the sandwich. If they over-regulate, people like me complain, if they under-regulate and an HIH occurs again, they are publicly slammed.

For governments and politicians, the same difficulties arise.

The problem is, this leads to a tendency to be safe rather than sorry. This leads to a tendency to over-regulate to try and ensure nothing goes wrong “on their watch”.

And that over-regulation, like the creep of bureaucracy, can strangle innovation, can artificially remove and create markets and levels of competition, and will add to the cost burden on consumers.

Sometimes it is too late to protect the victims, as we have seen in corporate collapses like Ansett and HIH.

It's like trying to legislate against stupidity, something we have done much of in Australia, although we are still well behind the Americans.

For example, in the US in 2002 Mr. Merv Grazinski of Oklahoma won a court case for negligence from a car company.

Mr. Grazinski purchased a brand new Winnebago motor home. On his first trip home, having driven onto the freeway, he set the cruise control at 70 mph and calmly left the drivers seat to go into the back and make himself a cup of coffee. Not surprisingly, the R.V. left the freeway, crashed and overturned. Mr. Grazinski sued Winnebago for not advising him in the owner's manual that he couldn't actually do this.

The jury awarded him \$US1.75 million plus a new motor home. The company actually changed their manuals on the basis of this suit, just in case there were any other complete idiots buying their recreation vehicles.

Legislation and regulation just can't save some people, it seems.

Another challenge is meeting market expectations. While there are some journalists, analysts, investors, funds managers and brokers who spend the time and effort to truly understand listed companies, others do not.

It is a familiar, yet no less justifiable lament by CEOs and Directors like myself that, all too often, the market says one thing, yet does another.

In other words, let's call for, in fact demand, strategies for listed company boards and executives which build long term shareholder value.

After all, what we all want are strong, robust companies which make strong returns to their shareholders for many years to come, don't we?

While saying that, all too often this is thrown out the door when it comes to how the market reacts.

Instead of long term strength, we get short-term demands. They used to be annual, then every six months, then monthly and now almost daily.

While I am a great fan of Australia's continuous disclosure laws, and believe they are superior to similar laws in the US and UK, they may have inadvertently helped this short-term outlook develop.

So now the market demands long term valuable growth with short-term, quick fix results.

What is most surprising is that, many times, companies such as Bank of Queensland deliver on both.

The market may reward you, but all too often the focus centres on short-termism rather than the long term value-adding strategies.

Anyway, enough of all that.

At Bank of Queensland, we have burned brightly over the last few years, and we will continue to do so.

There is a definite market for us. Our franchise model is unique and being secretly studied and copied by many of our competitors.

Our branch-opening campaign has forced the big banks to reassess old-fashioned cost-driven policies and face the fact that they may have lost touch with their customer base.

We have disproved the notion that a small bank can not be competitive, and can not maintain a cost structure to support growth.

At Bank of Queensland we have significantly improved our efficiency while opening more than 60 new branches, 10 business banking centres and implementing a replacement of our entire computer system.

We have done this while still maintaining a customer satisfaction rating well above the majors, and close to the pack leader in Bendigo.

Ironically, what we once called the renaissance in banking is now a new wave being picked up by our peers, and competitors, and championed as their own.

Even the franchise system of establishing a branch network faces replication.

While some of our competitors whisper to their customers that a franchised branch is not as secure as one of their own, others are quietly building a strategic roll-out of their own franchise network.

Imitation is a great form of flattery.

Now I know there is always gossip in this industry, and sometimes it is directed at even the small players like Bank of Queensland.

For example, one of our Victorian branches had the opportunity to talk to a customer who had just walked out of the branch of one of the majors down the road with the cash from his CMA account which he wanted to deposit in our branch.

The staff member at the major bank branch had been very concerned because, and I quote: “you know the Bank of Queensland branch is a franchise and that, if it goes broke, you could lose all your money” end quote.

Now, this is, of course, nonsense. Bank of Queensland is a bank. Our owner-managers do not go broke and, even if they did, all customers are customers of the Bank as well as the manager and are therefore protected in the way of any other bank customer in Australia.

Now I do not, for one moment, believe this sort of comment has been directed from management, but it highlights how our expansion can threaten the so-called natural order of things.

Another one doing the rounds at the moment is that we are struggling to sell those branches in Queensland which are revolving from their current OMBs for various reasons, usually personal.

Firstly, the percentage of those branches has remained the same almost since we started rolling out the owner-managed branch model in 2001.

Secondly, we knock back more potential buyers, and potential owners, of our franchised branches than we accept – to the order of about 14 to one.

And thirdly, as a franchisee, we actually want some turn over in branches because it ensures we remain at the cutting edge of service and sales.

Either way, we have no trouble selling OMBs, although we are very selective about who we sell them to, and this means some times waiting for the right buyer.

The fact is, we are looking at converting some corporate branches to franchises – our first corporate branch sale in fact closed yesterday with our branch in Aitkenvale, Townsville - and may well take the opportunity to convert a franchise which becomes available to a corporate branch if its suits us strategically.

I hope that puts some myths to bed.

I know, for example, that our competitors have looked closely at our model. I know some of them have dismissed it, but I know most have looked twice, and even three times.

Now, before anyone here thinks I am some sort of conspiracy theorist, or that I have all the DVD box sets of the X-Files, I know this sort of stuff is normal in such a competitive business as finance in Australia.

After all, I have been in it for more than three decades.

In fact, it's almost flattering for Bank of Queensland to even be noticed by our much larger competitors.

But it is also indicative of the pressure cooker competitiveness which is in the Australian banking and finance industry, and which is driving good results for the customer, and the shareholder.

The industry is being forced into the artificial position I mentioned earlier where the big four remain in their dominant position, leaving them little room to dramatically grow in the next few years, at least domestically.

Bank of Queensland's model has proved that you can roll out a branch network quickly and at a relatively low cost.

This gives us a "first mover" advantage when it comes to new greenfields sites, or even suburbs which have undergone a rebirth. Some of our fastest growing new branches have been in inner city suburbs where we have opened a branch after every other bank pulled out 10 years ago.

The indisputable truth which the BOQ expansion has shown is that an incentive-driven franchise banking model is not only successful, but the wave of the future when it comes to providing banking services.

Australia has more franchisees than any other country, per capita, so it should be no surprise that while everything from fruit juice to cleaning services has been successfully franchised, banking should follow financial services such as mortgage broking.

Wizard showed how it could build a strong market presence through shop fronts, and so are we. Bendigo has a community-based franchise model, different from our entrepreneurial-based franchise model but still it can be no coincidence that we two top the customer satisfaction charts for banks every time.

Banking has caught up, under the Bank of Queensland model, with other industries when it comes to customer service.

Bank of Queensland has led the way in perfecting franchised banking where the important issues of credit, security, and brand are controlled rigidly by head office, while the vital market flexibility is enhanced through local area marketing, local knowledge and the consistency and continuity of a bank manager.

Flexibility where it counts, and protection for the customer where it is vitally needed.

So, the future is clear. Franchised bank branches giving genuine service supported by competitively-priced products.

Sounds easy, but I can tell you, it isn't.

And that's the key going forward for Bank of Queensland, to stay ahead of the pack even when the pack is dogging your every footstep.

That's the focus of a challenger and, in our case, our focus – which is, at the end of the day, to become a big small bank, not a small big bank.

Thanks for listening....