Turnaround Management Association of Australia Conference:

“Sink or swim – Sharks in the water”

October 2, 2008

I’m delighted to be here today talking to a group of people who are passionate about business and, specifically, about helping businesses find solutions to the impediments stopping them from reaching their full potential.

In my experience, a lot of companies do not under-perform, or even fail, because of poor business decisions or because management acted in rash or foolish ways; it’s their *failure* to act that is their downfall. This failure to act can be the difference between sinking and swimming.

While I have always believed that persistence is absolutely fundamental to business success, I also believe that successful businesspeople are able to identify when change is required. These may seem mutually exclusive traits, but I assure you they are not.

And being able to determine when to persist and when you need to change tack is even more important given the difficult times in which we are operating. Over the past couple of weeks we have seen financial giants like Lehman Brothers collapse, Fannie Mae, Freddie Mac and AIG bailed out by the US government, and the investment banking model in the States essentially go to the wall.

And then we woke up on Tuesday morning to the news that the US Congress had rejected the proposed bailout plan which was designed to restore confidence in the US banking system, and $1.1 trillion was instantly wiped from the US stock exchange.

It has been three weeks unlike any I have seen in my 40 year banking career. And it has changed the face of banking in the US forever.

It's safe to say that in terms of the sinking or swimming analogy, the US is definitely sinking.

And while the situation in America has had a significant impact on Australia in terms of the huge swings in our stock market, and the resulting impact on superannuation and changes to legislation in terms of the temporary ban on short-selling, it doesn't mean that Australians should start panicking about the security of Australian banks.

Australia is fortunate to have one of the most safe, stable and highly regulated banking systems in the world. Our banks today are among the best capitalised in the world and are prudently managed using international best practice.

But don't think I'm glossing over the crisis. The sub prime crisis has definitely had an impact on Australian banks, particularly in terms of the cost of funding, and this is particularly true for small regional players like Bank of

Queensland and Bendigo/Adelaide. Because we don't have the Double A rating of the major banks here in Australia, we have to pay more for our wholesale funding. And while this is causing some angst and maybe even a few sleepless nights for my CFO and Treasurer, I am confident that our funding mix is where it needs to be.

But despite all that, being a smaller regional player does have some advantages. We don't have exposure to the poorer quality or 'sub prime' lending.

We have no exposure to Lehman Bros, Merrill Lynch or AIG, or any corporate lending for that matter. I can't say much more until we announce our full year results next Thursday, but let me assure you that BOQ is in a good place.

Now will this impact small to medium sized businesses, in terms of changes to bank behaviour? Of course. It would be foolish of me to say otherwise. Risk has been re-priced forever as a result of the sub-prime crisis, and this of course impacts businesses looking to borrow money. It impacts not only the cost of borrowing money, but also access to this money. You can rest assured that after the huge exposure to bad debts faced by Australian majors like ANZ, banks will be tightening up their credit policies even further, which has the obvious knock-on effects for any business wanting to borrow money. It is no over-statement to say that the face of Australian banking has changed forever.

But I have digressed. We were talking about the importance of knowing when to persist, and knowing when to change track. So let me first talk about persistence.

Ray Kroc, the founder of McDonalds, said it well: “Nothing in the world can take the place of persistence. Talent will not – nothing is more common than unsuccessful men with talent. Genius will not – unrewarded genius is almost a proverb. Education will not – the world is full of educated derelicts. Persistence and determination alone are omnipotent.”

That is a great quote, and sums up the importance of persistence beautifully.

Like you, I have read many, many business and success books. You know the ones – “How to take over the world in 40 days with a calculator” and “How to become a millionaire by writing a book on how to become a millionaire”, and even “40 habits of successful people, by a previously unsuccessful person.”

There are a million of them.

One which you might not have read, but which is worth having a look at, is “Don’t die with the music in you” by outgoing Broncos coach Wayne Bennett.

Apart from the fact that I love a good quote, and so does Wayne, it is full of the sort of practical advice on life and business which you would only expect from rugby league's most successful living coach, whose departure from the Brisbane Broncos brought a tear to many a Queenslander's eye.

In his book Wayne has a chapter called "Keep going until the siren sounds" in which he outlines the value of perseverance in football, and in life.

In it he says, and I quote: "Almost every successful person could not remember doing anything great he or she had achieved without, at some stage, having wanted to tear it up and quit."

He goes on: "That is the difference between the success and the failure….those who won't take risks and go for it, who won't see things out, they're the ones who come home early, never answering the challenge and never going anywhere."

Good stuff. So, perseverance goes hand-in-hand with risk at times, because it is often all too easy to take the simple path, or give up when the going gets tough.

But Wayne also understands the importance of knowing when it's time to change tack. His chapter about winning is titled "If you do what you always did, you'll get what you always got", and I think that sums it up perfectly.

When I became Managing Director of BOQ in 2001, BOQ was doing OK. It wasn't a sinking ship, but it certainly wasn't outperforming.

We had one of the most identifiable brands in the State yet only six per cent 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'd keep getting what we'd always got. We'd be swimming around in circles, so to speak.

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 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. But in my mind, that was more sinking than swimming.

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 to the market, and analysts can build a standard model in which to place Bank of Queensland. I would liken this to a 1500 metre race – a long, slow slog.

Or I could take a more radical, riskier path. Well-managed risk combined with perseverance could perhaps win the day. A true turn-around – perhaps a 100m sprint.

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 understood the vision, and an 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.

But 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.

We were not going to stop our race mid-way, or worst of all, sink.

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, and the market began to respond, driving up our share price.

So, a share price of around \$5 is now around \$15, our market capitalisation has more than quadrupled to almost \$2.4 billion and net profit after tax has jumped from \$24 million in 2001 to \$106 million last year.

We were rewarded for our persistence… and for our fast swimming.

So, perseverance, mixed with a little risk, paid off for Bank of Queensland, but it was perseverance in an entirely new business model, an innovative model, rather than persistence in the old model. And that is the key.

So the real question is, how did we combine innovation and perseverance and support our calculated risks? How did we know that swimming wouldn't actually end up as sinking – or worse, deliver us to the sharks?

Well first, to innovation.

In 2001 Bank of Queensland 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 worked and 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. Many found the idea of leaving a full banking environment to sell a single product less than appealing.

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 we picked only the very best of them

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 168 branches, we now match or exceed almost all the other banks' Queensland branch presence. We have opened 197 franchised branches, including 79 in NSW, ACT and Victoria, since beginning the roll-out seven years ago. We now have a total network of 284 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, hopefully including some of you here today.

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

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!

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.

But it is more than just the branches. While branches are the key to offering excellent service, modern banking and the extra functionality and convenience it offers is about much more.

So realising our ATM network in 2003 was limited to just one state and even then were pretty thin on the ground, we purchased ATM Solutions Australasia, a provider of convenience ATMs located where people need them.

Not only did this give us the most widespread ATM network of any Bank with more than 2,400 machines, it also allowed us to showcase our integration and entrepreneurial skills, as we expanded and sold the company less than two years later for a net profit of $15.5 million.

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, establishing the largest presence in Queensland of any bank.

And in December 2007, Home Building Society shareholders voted unanimously for a friendly merger with BOQ 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 last weekend we successfully integrated Home Building Society. In fact, we're nine months ahead of our original plan and with significantly greater synergies realised than budgeted for.

Now this has all been a very positive story.

It has certainly been a story of swimming – fast swimming - for BOQ, but as I touched on at the beginning of my presentation, the pool we're swimming in has certainly changed. The sharks are circling.

Whilst there has been a slow down in demand for loans in Australia, due to the higher interest rate environment and the downturn in consumer sentiment, we are also hearing that some banks and financial institutions are deliberately slowing their lending, in an effort to reduce their debt requirements.

This concerns me, particularly from a business perspective, as for a strong economy we need ongoing business investment, and therefore we need money available to fund that business investment.

I would like to point out here, that this is definitely not the case with Bank of Queensland – we are very much "open for business" – no pun intended!

Businesses of all sizes need access to capital to grow and thrive – to swim.

This current situation obviously presents an opportunity for all of you in the room, as turnaround professionals. Businesses need your advice and help – when to persevere, how to execute. They need swimming coaches.

It's an opportunity for services like debtor finance, which used to have a negative, desperate stigma attached to it, but now is becoming a commonly accepted good business management tool.

But this retraction in credit, if it continues, is a dire situation, and that's why I was delighted with our Federal Government's announcement last Friday night that they would purchase up to $4 billion in mortgage securities from financial institutions in an effort to restore confidence, and kick start investment back in to the Australian securitisation market.

This is great news for businesses, as it means that the smaller banks like us, who were relatively more reliant on securitisation and have lower credit ratings – and therefore higher wholesale funding costs – than the major banks, can access cheaper funding.

It will mean that more lending can continue, and could potentially help bring the price of that lending down; and perhaps most importantly, it means that small players like BOQ can continue to be a thorn in the major bank's sides.

It's important to understand that this proposal isn't a bail-out like the one proposed in the United States. This isn't about buying the problems of bad lending – we simply don't have that here in Australia.

Our low risk, fully secured housing lending, together with the Commonwealth Government's ability to use their Triple A rating to purchase these securities, will actually be a high returning, low risk investment for the Government which will return a budget surplus.

I see it as the Federal Government's move to ensure the Australian financial services sector keeps swimming rather than treading water, and I applaud them for it.

However, to be truly effective I think the pool will need to be bigger than $4 billion.

To really unfreeze the market, and restore confidence amongst investors and re-entrench true banking competition, the pool needs to be bigger.

Conclusion

But I digress.

In conclusion let me say that, with all this talk of sinking versus swimming, of how persistence, innovation and execution help companies swim, one thing cannot be forgotten.

And that is, in business, it's all about people. No matter what it is you make, how you market it, you must never forget that it is all about people.

They are what make a company sink – or swim.

The big banks forgot that for a decade or so.

At Bank of Queensland, we know that we are only as good as the people who work for and with us, and that our entire strategy is based on getting more customers. Not more accounts, not more businesses, not more dollars.

More people, that's what we want, that is our goal.

So, as I started saying today, persistence, and the ability to know when to change your approach, are key to success in business. I once heard a great line that has stuck with me through the years – "you might be on the right track, but if you stay there long enough you'll get run over".

I know that won't happen with the audience before me, because you, more than anyone else, understand how to help businesses get on to the right track.

Combine that understanding with perseverance and execution, and I have no doubt that you can truly turn things around for almost any business.

Thank you.