Thursday, 3 July

Let me start by thanking our local BOQ Owner-Manager Gary Kelly, the Mayor Ron Bellingham, and the local Chamber of Commerce for the invitation to speak here today.

Driving in to Warwick late yesterday, it was immediately evident that the economy here continues to grow steadily.

There's a bustle about the city, people are eating out, and businesses seem to be trading strongly.

I took a quick look at the economic indicators for Warwick and all the numbers are going in the right direction. Everything from dwelling approvals, to employment, to tourism, are on the rise.

This is no surprise, given the strength of the Queensland economy at the moment. But while the Queensland economy is strong, we are still operating in quite difficult times from a global perspective, which creates a number of challenges for businesses of any size.

So I'd like to talk to you today about the challenges I have faced trying to grow BOQ in difficult times.

I have learnt some very big and very important lessons along the way, which I've carried throughout my career.

The main one is that it doesn't matter who you are, or how big or small your wealth is in either a personal or commercial sense, at the end of the day you just want to receive good service.

To some people, good service in banking terms means having someone they know that they can call directly at any time.

To others, it's the ability to do their banking in whatever channel they choose, whether it be face-to-face or electronic.

And it is this lesson, that people just want to receive good service, which has been central to my leadership at BOQ since arriving over 7 years ago.

For those of you here who are not familiar with Bank of Queensland's story to date, I would like to briefly share this with you, and touch on where we are headed in these challenging times.

When I joined in 2001, Bank of Queensland was, in my view, chugging along.

It had a great brand, but had seen little growth above $5 a share for 30 years.

To be frank the Bank was 120 years old and in some ways, was showing distinct traits of happily slipping into the twilight of its illustrious life!

It was more an institution than an enterprise. Was more inward looking than eyeing distant horizons. It had bred a culture that encouraged conformity and repetition rather than reward competition and innovation. In metaphorical terms it was content to just idle along Australia's eight lane financial freeway -but it had potential!

Every step we have made since then has been designed to support our strategy of attaining more customers, of keeping them, and of growing their commitment to the Bank.

This growth strategy has seen a corresponding growth in the Bank as a whole, as our results continue to show.

In 2001 BOQ had 93 branches, only in Queensland while its competitors had around 130 in this State.

And today we have close to 300 branches, including 152 in Queensland alone.

In 2001 our statutory net profit after tax was $24 million, while in 2007 it was $102 million.

In 2001 our cash earnings per share was 38.2 cents, and in 2007 it was 93 cents.

In 2001 our loan approvals amounted to $2.8 billion whereas in 2007 they reached $13 billion.

And the share market has rewarded us for the growth. Our market capitalisation five years ago was $400 million and now it is around $2.4 billion.

It's a good growth story, and one which is far from over.

But growth alone is not the strategy. Growth without customer retention is little more than rowing a boat in circles. To my way of thinking and in terms of growing shareholder value, customer attrition risk in banking can be a bigger risk than credit risk.

Retention comes through customer service. Attraction of new customers more often now comes through good service and word of mouth. Growth in the commitment of the customer to the Bank comes through over-servicing and building relationships.

Can you see the trend?

The fundamental understanding which has driven this growth by Bank of Queensland is that we must match our competitors on product range, accessibility and innovation while out-performing them on personal service.

After all, we see our competitors as the Big Six, soon to become the Big Five if the Westpac and St George merger goes through, and even the smallest of these is more than ten times our size when it comes to market capitalisation.

We can't outspend them on TV advertising.

We don't have a huge residual pool of customers who are finding it too difficult to switch banks.

What we do have is a culture which is completely different from the traditional banks.

What we do have is an entrepreneurial network of branch managers and business bankers who are the best in their field.

What we do have is a nimbleness, flexibility and speed to market.

But most of all, what we have is a team behind the BOQ brand which actually does care about customer service.

And the team is, in turn, supported by a model which infuses the staff with a service culture.

It is interesting to note that when we changed the old agency model over to the Owner-Managed Branch franchise model in 2001 we believed we were creating a new culture in our branches.

What we did not anticipate was how that culture would push back into the other areas of the bank, driving change by its sheer dynamism, its need for a support structure which matched its own enthusiasm and drive.

Because the Owner Managers, like Gary Kelly here in Warwick, would not, and will not, settle for service from the back end which fails to match their own high levels out the front.

They would not be let down by systems and processes which stymied instead of supported their own service culture.

They demanded better, and we at head office have had to come up with the goods to provide them with better.

If you ask him, I'm sure Gary will say this is still a work in progress. After all we have had a lot of catching up to do.

And despite all this, and our internal surveys, it still irritates me no end when I hear we are number two when it comes to customer satisfaction in banks.

Mind you, earlier this week East & Partners released their latest research findings, which show that BOQ has taken out the number one spot when it comes to customer satisfaction in the SME segment. This is the result of a huge amount of work we have been doing in this space and it is fantastic to see this pay off.

And while this is worth celebrating, we absolutely must not become complacent. Complacency in business is death. We must ensure we remain number one for business banking. And we obviously still have work to do with regard to our personal customers.

In saying that, we have put everything in place to achieve the number one spot.

We've been busy over the past several years, including replacing our core banking system, opening about 180 new branches, rebranding and repositioning the bank, relaunching business banking, and selectively acquiring where we believed we had weaknesses.

This was supported in the equipment finance and debtor finance areas through the acquisitions of UFJ and the Orix debtor finance business.

It included the purchase of a small Melbourne based company called ATM Solutions which we doubled in size from 900 ATMs to 2200 ATMs, allowing us to have the second largest bank-branded ATM fleet in the country.

Now, they weren't on high street. In fact, you are more likely to find them in the local corner store or service station, but the fact remains they gave us an instant, national ATM fleet to support our national expansion.

In 2004, with a national ATM and business banking support network already in place, we started our interstate expansion. We took little old Bank of Queensland into the heartland of our opponents. As ancient Chinese warrior/philosopher Sun Tzu says, we attacked in undefended places.

We went back to the CBD, inner-city suburbs, strip malls and shopping centres, and back to regional towns like Warwick. And we offered them an alternative to the big guys.

At around the same time we made one of our more momentous decisions. We decided to stop using mortgage brokers to sell BOQ loans. We replaced these loans through our own channel within a year, and we haven't looked back.

We bought Pioneer Building Society in Mackay, adding $300 million in assets and 23 more points of representation throughout central Queensland.

And last year we bought Home Building Society in Western Australia, which has given us 35 branches throughout the Perth metro area (and a couple in the Margaret River region which I was devastated to find out about), $2.4bn in assets and importantly, in today's world, almost the same in deposits and another circa 126,000 customers!

Importantly, it's given us a real foothold in WA from which we plan to leverage and grow, and exploit the booming West Australian economy.

So it's been a busy few years, and it will only get busier!

But I would like to digress for a moment from the growth story of BOQ, because there are parallels between our Pioneer and Home amalgamations and your own amalgamations here in the Southern Downs.

Now I should say up front that I am a centralist by nature. I believe that a country the size of Australia does not need three levels of government. If we have robust enough local government, why the need for state government as well? It seems that we are almost getting in the way of ourselves.

But that's not what we're here to talk about. The recent amalgamation of local councils here in the Southern Downs does have its own challenges. And I don't doubt they're similar to the challenges that we faced with integrating Home and Pioneer. Not only did we have to integrate our systems to offer our customers a more streamlined and user-friendly experience, which I assure you is no easy feat, but we also had the challenge of integrating our cultures, without losing the unique and very valuable attributes of each.

And I imagine that you face similar challenges here in Warwick. Not only do your councils need to consolidate and streamline their systems and processes so they can provide a more efficient service to you, the constituents, they also need to bring together the unique cultures of both the Warwick and Stanthorpe Councils, to create an even greater Council, that has the best attributes of both.

And that's what we've had to do with Pioneer and Home. We've tried to retain as much of their culture as possible, because their culture was a large part of what attracted their customers to them and we don't want to lose that.

We actually think that, following our merger with Home, we now present an even more attractive proposition than either of us offered before. We have combined Home's local knowledge - which is so important to our West Australian customers, with BOQ's expanded product suite and nation-wide ATM network, and the friendly, personalised service that both Home and BOQ were known for. And I think what we have now is a winning combination.

So the newly amalgamated Southern Downs Council needs to ensure it doesn't lose sight of what is important to you – the local businesses and residents they are responsible to.

And hopefully what the amalgamation will mean is a more efficient and skilled Council, better able to service the needs of residents and businesses alike, without losing the local knowledge and flavour that made them unique.

But let me get back to the BOQ growth story and the economic conditions in which we are currently operating, because as business people I'm sure that's what you'd like to hear about.

Now as we all know, the events of late 2007 delivered us into 2008 and a somewhat unprecedented situation. The crippling of international credit markets began almost a year ago because of the US subprime mortgage disaster and it is generally felt that perhaps the impact could play out into the middle of 2010.

It is fair to say that no public company is totally immune to the current pressures, and I'm not going to pretend for a second that Bank of Queensland is totally immune either.

The ongoing nervousness of investors to back mortgage related securities, the worldwide repricing of risk, and the subsequent share market turmoil obviously impacts all companies – both banks and finance companies, who are suddenly faced with much higher funding costs, and all other businesses who need to borrow money from financiers, and therefore also face higher funding costs.

BOQ's cost of funding has increased, and our margins have subsequently been put under pressure.

We are not alone in this situation, all banks in Australia have the same issues, which became more transparent in the interim results reporting season earlier this year.

Although, I think it's important to point out that while all of our share prices are down, BOQ has still maintained a premium relative to our peers.

However it's not all doom and gloom!

In fact, just last week at a UBS Conference in Sydney, most of Australia's top banks revealed that they are holding up much more strongly than their overseas counterparts thanks to a mix of strong retail deposits, limited defaults and a history of being more selective in their lending policies.

As I have said earlier, no one's saying the crunch is over. In fact, most of the banks agree that the worldwide credit crunch still has up to two years to play out, but the global economic outlook has certainly improved.

In fact, just last week we announced that we are maintaining our guidance of cash earnings per share growth of 10 percent for this financial year, and we actually expect margins to improve in the second half of the year.

Our lending and retail deposit growth remain on track to be 2 and 2.3 times system respectively, and our investment in Queensland and Western Australia – the two boom states – continues to pay dividends in terms of growth and superior asset quality.

The key drivers are still in place – high employment and the consequent upward pressure on wages, continuing increases in commodity prices and the increased income as a result, upcoming tax cuts.

Even if the USA does fall into recession – if it hasn't already – the impact on Australia will be less than it would have been in the past.

A major concern has been that if consumer demand falls in the US due to recession, this will mean a decrease in Chinese exports to the US, a decrease in Chinese revenues, and therefore a decrease in Chinese demand for the Australian resources that are underpinning our strong economy.

However China is continually becoming less dependent on overseas demand as their government focuses on domestic consumption and investment as opposed to being completely dependant on exports for their growth.

In fact, only 2% of China's 11% growth last year came from the value that China added to its exports (that is, the value of exports net of the cost of imported raw materials).

In a corporate sense, the pain of the current credit crisis has not been widespread – it is has been confined to a few highly leveraged companies like Centro, Allco and MFS.

In a general public sense, the major impact of the credit crisis on Australians has been the increased interest rates as banks have been forced to pass on the higher cost of funding.

All banks access wholesale funding markets, to varying degrees, to bridge the gap between what is raised in deposits and the demand for loans.

As everyone knows, the global liquidity crisis has meant risk has been repriced, and the cost of these wholesale funds has increased dramatically.

Financial institutions absorbed the increased cost for several months, before starting to pass some of these costs on to customers through higher interest rates over the first half of this year.

This has unfortunately been exacerbated for Australians by the tightening monetary policy being adopted by the Reserve Bank at the same time, who are trying hard to curb inflation.

I feel one major potential negative impact of all of this in Australia could be a slow down in business investment ex resources industry. If this happens, unemployment levels will almost certainly increase and this would lead to significant pressure on families and our overall economy.

Most analysts are predicting at best no more RBA rate rises this year, but there are no signs yet of the wholesale funding markets significantly improving.

The situation we're in really is a conundrum.

As a customer-focussed bank, we don't want to increase our mortgage rates and potentially put pressure on families by increasing their cost of living.

But when our costs have increased, and the dynamics of our stockmarket insists that as a company you improve your profits and your returns every six months, what is the choice?

The answer is, as far as I can see it, to balance our shareholders' interests with our customers' interests.

BOQ has certainly tried to do that, and we will continue to do so going forward.

I'm sure many of you face a similar tension in your own businesses.

On a more macro scale, the answer I think lies in addressing the inherent short-termism that our public markets – and market analysts – demand.

Every public company CEO talks about the pressure of the markets constantly demanding quarterly or bi-annual results that are bigger and better than the previous results.

It is the treadmill of capital markets, making decisions based on constantly trying to meet the market's expectations – which are always a certain percentage point higher than the previous result.

It is one of the main reasons that private equity will always exist – buying public companies and taking them private and away from the constant public glare, taking the write-offs and making the investments that might not be accretive in Year 1 or 2 but are actually necessary for long-term, sustainable performance.

Then – voila – the company is performing strongly again, and can be trotted out for a market listing, and everyone makes a lot of money.

This is a very simplistic viewpoint, I know, but the short-term approach that is forced on public companies is very real.

Our current market structure demands more, better, fitter, faster, stronger… every three to six months!

Is this actually constraining the performance of listed companies? Who knows.

How could – or even should – this issue be addressed? That is for greater minds than mine to ponder.

But it is a fact of life for every public company CEO, and for every bank CEO, and so when Wayne Swan implores us think of the average working class family when we consider raising our mortgage rates - we do.

Well Bank of Queensland certainly does.

But we also need to balance this with thinking of our shareholders, and the markets' reaction if we fully absorb the higher cost of funding and subsequently release a lower profit.

But I digress.

Let me wrap up by saying that at BOQ, despite the challenging times, our prospects are good. We have an outstanding track record against our peers. We have a fabulous growth engine in our OMB model, and we have a lot of blue sky in front of us.

We have our platform for growth in place and are continuing to fire on all cylinders!

I won't go on any further, however I'd like to finish by posing everyone in the room a question.

Are you happy with your current bank?

No, come on, I mean really happy?

If not – give us a go! Our local Owner Manager Gary Kelly, who I'm sure many of you know already and who is here at breakfast this morning, will be more than happy to talk with you.

Thank you all so much for your time.