

**AUSTRALIAN INSTITUTE OF COMPANY DIRECTORS LUNCH
Brisbane, Thursday, 14 April 2005**

**Presentation by National Australia Bank
Managing Director and CEO, Mr John Stewart**

(This is an edited version of a keynote address delivered by Mr Stewart.)

JOHN STEWART – NATIONAL AUSTRALIA BANK:

It's great to be here today.

Strange though it may seem, this isn't actually a flying visit to Brisbane, I've been here most of the week and the corporate headquarters at NAB is actually running out of Adelaide Street in Brisbane this week. Now, that's really important for two reasons.

Firstly, a part of my cultural change in the bank that you're going to hear about later is actually that it's been Melbourne-centric and Victoria-centric.

And the other thing, of course, is the importance of this state; and the importance of this state to NAB, because I don't have to tell you the economic growth that's going on here. Last year it was about six per cent, which is phenomenal. The Australian economy is geared at three and a half to four per cent by world standards, but six per cent is just amazing.

And of course, it's driven by population, because you've got to have a population that's increasing; the population growth of your state is almost twice the population growth in the country.

And I'm really pleased to say that NAB has a long and proud heritage here. We were National Bank of Australasia, and the National Queensland Bank - both parts of what is now National Australia Bank. We have about two thousand staff who live

and work here. We've got 170 branches and that would be increasing in the growth corridors.

So, we have a huge presence here, and this is an important state to us.

So let me just start to talk a little bit about culture, if I may. I want to just read a quote that is about a company that you all know, by the way. And this company had an increasing tendency to become disconnected from reality, growing an internal culture of arrogance and complacency.

“They had a good news climate that discouraged honesty and challenge. They had internal silence and they were obsessed by process and they had lost contact with the changing dynamics of its market. And lastly, persistently missed targets and under performance.”

Now, you're probably going to think that what I'm quoting from is NAB, and it could easily be NAB, but it wasn't. It was actually at IBM ten years ago.

But all of those symptoms were there in the NAB - in the NAB, if you like, that I came into.

Now, the reason I'm telling you that is that IBM was a great company. But it lost its way. It is now a great company again. So, companies can be turned around if they understand what's wrong with them and they're prepared to face into it.

We've seen this in lots of big companies around the world. Marks and Spencer is another one. I mean, when I grew up in the UK, Marks and Spencer was seen as an icon for retailing. If you wanted to know about retailing you went and you bent down at their feet. And of course, it lost its place. And that's a company that hasn't yet come back. And I hope it does, but right now it's in the bottom of the 'U'.

So you will have noticed that we're not in the press quite so much nowadays, which I'm delighted to see, and that's really because we're working very quietly, trying to rebuild the company in a number of ways.

It's really in four ways. Firstly, compliance and control. In any company, that's important, but in a bank that's very important, and we've managed over the years to lose quite a lot of money with bad compliance and bad controls. It was, at the end of the day, shareholder money.

Secondly, we stalled our income. You can't have a company that doesn't have a healthy income line. There's only so much you can shrink to greatness. There eventually were no more costs to cut. So you've got to get your top line moving, and I'll come back to how that's best done later.

But the other thing when we talk about costs, is NAB had made itself an incredibly complicated company. And our customers found us difficult to do business with. What we've got to do is change that to a company that's actually easy to do business with.

Now, that doesn't mean that we're a patsy and we say yes to everything. It just means we have quick processes and we become slicker. And guess what happens? When you become easier to do business with, your costs actually go down.

But what I want to speak of most, though, is people and culture.

Now, the people are important because if you don't have really top class people in your organisation, trust me, you are not going to be successful. You've really got to get the best talent you can. You've got to get the 'A' players that are out there, because most people who are any form of seniority, can't do it on their own efforts. It's people who work for you who make you successful. You've got to really pick the best.

We've always been very lucky that our front line staff - our relationship managers - are great. They're fantastic. Very few people have to change. The problems, really, that I encountered were people at the centre who had become too self-important and quite frankly weren't good enough.

So I changed a lot of the people at the centre. Within my executive committee, there is only one person doing the same job they were a year ago. Two people that were there a year ago are still on it, but doing different jobs. All the rest are either from outside or from inside or I promoted them up. That's huge change.

Now, in terms of the culture, in 2003 there was a whole program that I'm not going to go into the details about, but I can tell you the mainstay in terms of culture was corporate principles.

In 2003 we'd actually gone globally to our staff and we consulted with five thousand staff. That's, you know, pretty big representation. We asked: "What's the company you want to work for; what should its values be?" And they came up with a range of things. The first one was to be open and honest.

Now, what has happened in our company happens in most companies. You've got the values, and what do we do with them? Put them on the shelf. Ignore them. Just get on with life as life went on before. So, when we realised we had to do something about this, we actually wrote the behaviours that we expect if you're going to work at NAB. So, what's the first one: tell it like it is with no spin, have candid and constructive conversations. So, these are areas where we want people to behave this way.

More importantly than that, there are proof points underneath these behaviours that we audit. So, if you're going to be open and honest, if you're doing that, this means these things ('proof points') should be in place.

And guess what I learned a long time ago? People do what you inspect, not what you expect. So, if you're going to want change of culture, you're going to have to say this is the rule. So that the people who are behaving well, they will be promoted faster, will get bigger bonuses. The people who are not doing it, we'll have some conversations with. And the ones who are persistently not there won't work here anymore. Because right on the front page of the corporate principles – so we couldn't be any more obvious – it says, “and we do not have room for people who do not live these principles”.

Now, the first time I found out the importance of culture was actually the first company I ever started. That was a financial advice company in the UK. We had been given permission to start a pilot subsidiary, by the board, and that pilot was successful.

Well, we were all in our early thirties, and we we're really excited, and so we thought it was *our* company - this was our baby. So, after the end of the pilot, we had learned some lessons.

We wrote down the company we *wished* we worked for; not the company we did work for. How would it treat its customers? Would it sell them anything it could get away with, or would it actually make sure it was adding real value to a customer? How would we recruit our staff? How would we remunerate them? It was all written down and there were eight or nine pages of this.

Over the next decade, that company increased its profits at 35% compound. Now, I can't take the credit for that, because I was CEO of it for one year and I went off and started a life insurance company and, after that, a trust company, as well.

The point is, we'd written down the culture. We didn't know we were doing it. We weren't being smart ... we were just kids. We wrote it down, and then people did it. So, the next people who came in: they knew this was how things were done.

The company has been frighteningly successful. It is now the biggest of its type in the UK. And, if you think, well John, that's just experience; but what does that have to do with me and my company? Well, something that I've been watching across the world – and the Attorney General and I were talking just over lunch about this – is that, I'm not sure it's enough now, guys, to run your company for financial credibility.

I know you've always had to do that. As directors, you have to get your financial credibility with the market, or with your shareholders. But you'll need ethical credibility as well.

If you look at what happened with Enron and Worldcom and Tyco – well, they've really changed the landscape as far as company directors are concerned. And they've brought us lovely corporate governance things, like Sarbanes-Oxley, which I'm sure you love.

But, if you look at the other things that are going on at the same time; for example Citigroup is the biggest bank in the world. And yet, its ethics started to be questioned by Elliott Spitzer, the New York Attorney General. What happened to Citibank? Fines and legal costs associated with poor corporate governance uncovered by Spitzer totalled hundreds of millions of dollars.

And then, in Japan, it had a problem with its private bank and it lost its licence. Top bankers – these are fabulous bankers – fell on their swords and resigned.

And if you think of Enron: look at the price you have to pay nowadays, because if you get your reputation right, then your company's going to be successful, but if you lose that ...

Whatever happened to Arthur Anderson? One day, it was the biggest accountancy firm in the world. Where's it gone? It's gone. It's disappeared. It lost ethical credibility.

Look at Worldcom: former CEO, Bernie Ebbers, is waiting on sentencing, and could go to jail for twenty-five years. Look at what's happening to Merck just now, in the US. Look at what's happening to AIG in my industry, in the insurance area.

There are lists of companies. The standards across the world are getting higher, and we've got to pay attention to it.

But just going back to a more micro level. I've done this before. In a previous life, I had to change the culture in a bank – you actually never change it; you just help it to change - and that was tough.

And in that previous experience if you had said to me at the end of the first year, "what's happening John?", I'd have told you I was losing, and that I was really at the point of throwing the towel in because I went to meeting after meeting and everybody agreed with me, said that's what we had to do. Nothing changed.

It was really slow. And then you get to a tipping point and it goes up exponentially. Two years later that bank was the highest rated bank in Britain, and it was moving, it was fast, it was innovative. And another thing... it was great fun to work there.

During that journey, though, I met four types of people that I'll share with you, because in your own businesses, you're going to meet them.

The first ones are the 'earlier adopters'. 'Early adopters' are great because they make you feel sane. They say, this is the way the company should run, you're doing the right thing, boss. And they help you.

The second group are the 'chameleons'. They just change colour. So, they can work with the old lot and they can work with the new lot. They're not worried. They're just flexible.

But there are two you've got to pay particular attention to. That's the 'can't dos' and the 'won't dos'. Now, the 'can't dos' have a skill problem. They need you to teach and help them do something, or they have a confidence problem, so you've got to mentor them and coach them. But when you get those guys through they will be successful and they'll be really loyal to you in the company.

The ones you have to watch are the 'won't dos', and you've got to get them out as quickly as you can. Let me describe a 'won't do'. A 'won't do', for example, is a NAB guy sitting here today, he goes out and he has a drink after work and says, "did you hear that load of tripe that that little Scots guy was talking?" And he says, "it's never going to change. I've been with NAB twenty years and it will always be the same. He'll be gone in two or three years and we'll just go back to the same way".

These people are poisoning the water. They're also often very clever. Does anyone remember the comedy show 'Yes, Minister'? And remember the minister would want to do something good, but Sir Humphrey would always say, 'wonderful idea, minister, if only we could'. And he'd give all these reasons why it couldn't be done.

Now, you've got to get them out because they're poisoning the water for the 19 year old who actually wants to get a hold of this stuff. They're thinking, 'well this guy's been around twenty years, he might be right', and when you do get the 'won't dos' out, it's like the sunshine coming out. So it's really important with any cultural change that you identify those people.

Going back to NAB, I'm pleased to say there were some good early signs. It's a long journey, but if I just quickly take you on a quick helicopter tour across the Group. The UK is where I came in to try and fix the problems. We've had problems there for a long time. I've got to say, mostly of their own making because we haven't invested in our businesses and historically they've just been run for returns. But having said that, the signs are really good. We've got a very clear strategy

now. We've sold the Irish banks, which was an excellent transaction at a good price.

We're now developing the UK mainland banks. We had a recent analyst conference in Sydney, and the reaction from that was two things really. Firstly, people were impressed by the quality of the team. That comes back to the importance of the quality of your people. These are great, first class locals. Secondly, the analysts could see just how advanced we were. In other words, we weren't just making promises. We're at least a year into a strategy and well into the turnaround.

New Zealand is probably one of my favourite banks; we have a great bank there. And probably one of the hardest places in the world to run a bank because customer service is just so high for everyone. Now, I'm pleased to say that we ran the best call centres in New Zealand - I'm talking just about banking call centres, I'm talking about the best call centres anywhere. So again, it's a very high standard. We have the best bank branches in New Zealand, and they're running a campaign just now called 'Unbeatable', which I think is truly self-evident.

So, that's a bank, really, that I don't lose any sleep about. And that probably brings me to what's going on here in Australia. In terms of our market share, there's a lot being written about NAB losing market share.

But we have been getting market share back to our normal levels, if not above, and this is in all of the main segments that we now operate in and which we want to get market share back.

We'll introduce tons of new products and an important thing is our customer focus. There are great deals for the customer – we are not necessarily starting off with great deals for the bank.

And MLC, our wealth management company, remains number one in platforms. It's also number one in individual risk (life insurance is another word for that). It's

number two in retail funds under management. And the biggest concern there, as part of our cultural change, is to bring the bank together with MLC in Australia, and people are worried about that. We'll be taking a risk we didn't have to take.

I've got to tell you that many of MLC's top executives are now running the bank, and that's going well. It's early days, but the signs are fantastic. We're not having problems of the two cultures knocking against each other.

Now, what does that mean for Queensland and what does it mean for our operation in terms of the retail bank that you have to deal with all the time? Well, the first thing is, I had a big corporate centre which I'm dismantling as quickly as I can, because that's where things were pulled into Melbourne and decisions were taken there. In fact, when I was here in Brisbane in about July last year, I visited a number of places, and one of the places was one of our business banking centres. I met this young business banker, and he said, "John, I have a delegated authority for \$200,000". This is banking speak to mean that he can sign loans up to \$200,000 without referring them to anyone else.

He said, "how many, as a percentage, do you think of those I can sell without having to refer them to someone else?". And I said, "well, probably 90:10. So, you will sign 90% of them, but there might be 10% that are a bit more complicated that you'd have to send off to the risk management people". And he said, "John, you're right, but you've got it the wrong way around. And it isn't quite 10%, it's 6%".

So, he could sell 6% of the loans that were within his own authority. Have you any idea how costly that is for my business? Have you any idea how frustrating that is for the customer, and how that young banker gets disillusioned?

I'm told, when I was chatting to some of my team yesterday - and this is them saying this, not me; I hope they're not telling me what I want to hear - that now 90% of all lending decisions can be signed in the states. So, we've gone completely the other way.

Also, the risk management people who used to sit in places like Melbourne and make these decisions ... over the next couple of months will be relocated here. They're going to sit right beside the banker; they're going to be encouraged to go out and talk to customers – actually see customers: I mean, that was frightening in the past.

So, you can see the changes here. And okay, maybe 10% still have to be referred, but we're getting much faster at that. You will notice recent cases in the public domain. For the Patrick Corporation's takeover bid for Virgin Blue, we fully underwrote the whole deal. We did that within days. So, that wasn't three months and maybe some white smoke will come out of at the end of three months and tell you whether or not we're going to lend to you. This was within days, on the phone; this is how we're going to do it.

We've no doubt that NAB will come back and it will be the banking force in Australia. But I guess we'll also say to you, I'm not in a hurry to turn this around for two reasons. One, I've got to get it right, it's got to be stable. The worst thing that could happen to this company now is that if we do that and then mess it up. So the thing is, it's got to be safe as we bring it around. If that takes six months longer, I don't care.

The second thing is that it's got to be customer focused. We have got to actually make sure that we understand that this bank will only be successful if our customers are successful. So, whatever their ambitions are, we have to realise that. We're just helping them. We're doing that, and in doing that, we actually make money.

So, coming back to the states, Queensland is going like a train and we love that. And as the state develops, we want to be there. Now, we've been here for a 150 years; we want to be here through the good times and the bad times, and not just the state, also the city, also your business and also you, as individuals.

And we're not going to go back to the old NAB, which was a rather insulting parent-child relationship. NAB knew better, because we were the bank. But this has to be an adult to adult relationship.

And what's important to us is that your success - as an individual, as a business, as a city and then as a state - is the only way we'll be successful. And one of my cultural challenges is to get my people to understand that and to make sure that they will be successful by having happy customers. And the way that it works, quite frankly, is happy staff make happy customers make happy shareholders.

Thank you.