
“Mirage or miracle? Adapting to the New Economy”

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Mr chairman...ladies and gentlemen

It is a pleasure to have this opportunity to speak for the first time at an Australia - Israel Chamber of Commerce luncheon.

This function has long been recognised as a valuable opportunity to discuss issues of general industry and community interest.

Your timing is impeccable...it is a relatively quiet period in the world of banking and financial services.

With little to distract me...I have been able to spend time considering the appropriate topic for today.

I have recently returned from a series of meetings in the United States...Europe...and Asia.

I met with leading fund managers, market analysts and industry representatives to discuss trends in their local economies and industries...as well as brief them on the outstanding prospects of Australia.

In every location the topic of conversation inevitably turned to the so called "New Economy".

In particular...it was interesting to note the different approach and psychology of United Kingdom and United States fund managers.

The impact of new technologies on banking is more widely understood by funds managers in the United States...and they believe that banking and financial services will be one of the sectors that will benefit from the New Economy.

There is no doubt that what was originally thought to be nothing other than Wall Street "hype" or fantasy has now become a significant influence on capital flows and investment throughout the world.

This – in turn – is impacting upon the strategies, performance and market attractiveness of Australia's major corporations.

Given that Australians now lead the world in terms of individual share ownership...anything that has a major impact on share prices and company performance...should be of general interest.

The growing number of retirees who rely on sustainable returns from their equity investments - either directly or via investment funds – also increases the relevance of discussions about current economic trends.

Today I want to discuss briefly my views on:

- Some of the key characteristics of what is being called the New Economy

- The impact of these characteristics on Australia and its major corporations
- And the response of the National Australia Bank Group

My conclusion is this: Australia and its major corporations have much to gain from the changes commonly associated with the New Economy and are already well placed to do so.

However, these gains will require a collective approach on the part of government and industry that will need to address not only policy and investment needs.

There is also a need to constructively address community attitudes to change and the degree to which the benefits of economic and industry transformation are equitably shared.

This is particularly the case with banking and financial services...a sector well suited to the strategic and operating demands of the new economic environment we face in Australia and globally.

Let me begin by giving my views of the New Economy.

I believe we are simply seeing the latest series of impacts from three broad trends – globalisation...major advances in computing and telecommunications technology...and deregulation of trade and financial markets.

These trends have been influencing economic and business trends throughout the past decade.

They should not have led to any excitement about a new economic era.

What has led to recent comments about the emergence of a New Economy has been the extraordinary period of sustained growth and relatively low inflation in the United States.

People have suggested that globalisation and technology have combined in the United States to bring about faster productivity growth...higher profits...higher wages...and lower inflation.

From that they have made heroic assumptions.

First...that technology will lead to permanent productivity growth...second that traditional links between rapid economic growth and inflation no longer apply...and third that traditional methods of valuing and pricing equities no longer apply.

They have argued that conditions in the New Economy will mostly favour certain industries such as computing...internet services...telecommunications...and media...and not others such as commodities, manufacturing or financial services.

That has led to massive movements of equity funds into the so called “high technology” stocks.

They have also suggested that national economies that are not home to plenty of these high technology industries will inevitably suffer from low growth.

It is clear that there have been substantial flows of funds into new technology stocks.

In Australia, a recent analyst report estimated that 40 per cent of the market capitalisation of the All Ordinaries Index is now represented by convergent technology companies in sectors such as telecommunications, media, computer and internet services...this may rise to 50 per cent within a few years.

According to Merrill Lynch, in the United States the technology sector has grown from 20 per cent of US stockmarket capitalisation in 1997 to around 34 per cent now...and continues to rise.

From a bankers' perspective, the signs of financial market excess are evident in the massive growth of margin lending in the United States.

Borrowing in the United States to buy securities rose at an annualised rate of over 400 per cent over the past quarter...that accounted for more than 25 per cent of the growth in total US bank lending.

It has been estimated that US margin debt as a percentage of market capitalisation has recently exceeded the previous record set in September 1987...a period that I am sure many of you will recall.

Rather than the New Economy...I believe that what we are seeing is simply the economic impact of the widespread application of computing and telecommunications technology.

The difference between today and five years ago is the pervasiveness of the technology and the subsequent impacts...not the rules and principles governing the economies in which these impacts are felt.

So for me the issue of Old versus New Economy is less important than the issue of how rapidly countries and companies reap the benefits from globalisation, technology and deregulation.

And in that regard I believe Australia is very well placed.

It will also come as no surprise to you when I note that the banking and financial services sector is also well advanced in its transition to a globalised, high technology operating environment.

In fact...I believe our industry is further advanced than most others in Australia.

That is because our industry was one of the first to be impacted by globalisation and technology.

Australia's banks are in the third phase of their "post deregulation" transformation.

The first phase followed deregulation 15 years ago and saw the entry of foreign banks and the commencement of changes to strategies and structures of Australian banks.

The second phase during the late 1980's and 1990's led to fundamental changes in structure, marketing, product distribution and operating processes.

This was the period when our industry felt the full impact of globalisation, technology and deregulation.

We have now entered the third phase which will see the completion of the strategic, structural and operational transformation of our industry.

In a speech delivered in 1995 to a company directors luncheon in Melbourne, the past CEO of the National, Don Argus told his audience this:

“At the National...we use the term convergence to describe the trend where rapid technology advances and the emergence of non traditional competitors are increasing the products and services offered to customers...”.

The point I am making is that for nearly a decade now, globalisation, convergent technology and deregulation have been the driving forces behind the fundamental changes that have occurred in banking and financial services here and internationally.

The changes implemented by banks have resulted in significant productivity improvements.

Contrary to what many people believe...the benefits of these improvements have been passed on to bank customers.

In its latest Bulletin, the Reserve Bank of Australia notes that the interest margins of banks are now “about 40 per cent lower than in the late 1980's”.

Housing borrowers and small businesses have benefited most, the Reserve Bank says.

This fall in margins has been reflected in the operating income of banks decreasing from about 5.5 per cent of assets to about to about four per cent now.

Australian bank margins are now below those of banks in the United Kingdom and Europe.

This fall in operating income has been matched by a similar fall in operating costs.

So through fundamental process and distribution changes, accelerated use of technology Australia's major banks have significantly improved their productivity.

That has enabled them to maintain profitability.

The reason I raise these matters is to highlight two points:

First – Australia’s major banks have been amongst the first of our industries to adapt to the conditions that some are calling the New Economy...and they will continue to be in the vanguard of the industrial changes that are necessary for Australia’s economic success.

Second – Australia’s major banks have been instrumental in bolstering this Nation’s ability to weather Regional economic crises and to maintain a level of economic growth that is amongst the highest in the world.

It is pleasing to note that both the Prime Minister and our Federal Treasurer now publicly acknowledge this.

Our Federal Treasurer, Mr Costello recently noted that the Australian banking system had become a model for other countries.

His views were endorsed by the International Monetary Fund in their latest report on the Australian economy.

The IMF listed the “strong financial position of banks...” as one of the factors that gave the Fund confidence about Australia’s economic prospects.

It is hard to reconcile these facts with the consistent demonising of banks by politicians and others in Australia.

It would seem contradictory to be called a “model industry” and a key contributor to Australia’s economic strength...and also be accused of having sub standard service levels and operating with limited competition.

This is what I would call the “political paradox” that must be addressed not only by Australia’s banks...but all industries embarked upon major transformation.

Politicians recognise the quality of Australia’s banks and their fundamental role in Australia’s economic performance.

Yet they also believe that the corporate sector does not contribute enough to the process of public education about the necessity for change.

Nor do they believe business is sufficiently sensitive to the political implications of seemingly rational corporate policies...the unrest in rural communities being a current example.

The image problems banks face in Australia are related to the fact that they have gone faster than other industries in responding to the demands of a changing world.

They have also gone faster than many of their customer...employee...and community stakeholders could manage.

Banks have focussed on the necessary task of transforming their organisations.

They have assumed that the logic and necessity of that transformation would be clearly understood and appreciated by all stakeholders.

In retrospect...that has turned out to be a fundamental error of judgement.

Along the way they have compounded that error by actions such as the ABA/Laws matter that have called into question their ethics....and their relations competency.

The recurrent issue that is causing the most friction between major banks and some stakeholders is that of service "access".

For some stakeholders - changes in the physical distribution of products and the imposition of fees – becomes an "access" issue.

Yet these are the necessary outcome of banks' adaptation to the changes in competition, structural and consumer preference.

Of course, these "access" issues are not restricted to the private sector.

Federal and State Governments have sold an estimated \$50 billion worth of assets and businesses in just over a decade of "transformation".

This massive transfer of State assets to the private sector has exacerbated community concerns about long term access to services.

It is interesting to note that the sale or disposal of assets by Government is considered to be in the community interest...much smaller sales of assets by banks, however, are considered socially irresponsible.

As access issues rise to the top of political agendas throughout Australia there is a real likelihood that the pace of much needed industry transformation will be reduced.

Ultimately...that will be at a cost to all Australians.

The momentum that has recently been generated by technology advances and the associated start up of a new generation of companies will continue to build in Australia.

In Australia there are three broad categories of businesses who stand to benefit from electronic commerce:

- Those who provide computing, telecommunications and systems technologies, as well as information content
- Those who can rapidly employ these technologies to improve their current processes and overall productivity
- And those who both employ the technologies and also act as facilitators or intermediaries for the deployment of electronic commerce

Australia's major banks are clearly in that third category and are in the vanguard of industries benefiting from electronic commerce.

The key point, however, is that all Australian consumers and all of our industries stand to benefit from the opportunities provided by electronic commerce and technology in general.

Whether it be banks or other industries, Australia's ability to fully realise the benefits from the New Economy depends on our ability to overcome a number of challenges.

The most important of these is the promotion of the benefits of economic and commercial change...And ensuring these benefits are equitably shared.

The current debate over rural service access is an example of these challenges.

The deep seated concern in rural electorates about access to services is clearly an issue of considerable political, economic and social importance.

However, it will prove costly for Australia if it exerts a disproportionate influence on policy – or slow the necessary pace of industry transformation in this country.

In the case of banks, I believe we need to separate issues such as rural retail service provision from broader matters such as banking and financial sector regulatory reform.

It should be possible to address one without retarding progress in the other.

We also need to keep in perspective the situation regarding the provision of banking and financial services for the rural sector.

Access to branches is one dimension...and perhaps the most controversial.

Yet there are other dimensions that are perhaps more important.

The National Australia Bank is the largest lender to farmers in Australia...last year our agribusiness lending totalled \$6.6 billion.

Importantly...our lending has increased by over 12 per cent a year for the past two years.

We have the largest network of agribusiness specialists...having increased this during the past three years to our current level of over 300 specialists.

We have over 40 per cent of our branch and banking outlets in rural areas despite the fact that we are servicing just over a third of Australia's population in rural areas.

I raise these points because there are continuous – but never specified – demands for banks to adopt “socially responsible” approaches to rural service delivery.

I would also note that where some service providers can expect to receive subsidies for their rural operations, banks are expected to meet all costs from their revenue.

If we need to go further...I would be pleased to work with the Federal Government, other services providers and rural communities to decide exactly what is required and what constitutes the necessary "social dividend" for rural communities.

I am not disregarding the genuine concerns of those in rural communities.

What I am suggesting is that current criticism of service suppliers and threats of regulation will simply serve to diminish rather than increase access.

It may be good politics...but it is not good government.

What is required is a collective effort on the part of government, industry and community to soberly address the extent of access problems and share responsibility for their resolution.

I have an open mind on matters such as tendering for services in rural areas...the establishment of jointly operated services centres...the subsidisation via taxation revenue of services for consumers with special needs...improved education of consumers to assist access to electronic commerce services...and fee free accounts.

During the past 12 months the National has been working with a representative group of community service organisations to candidly and constructively discuss access issues.

We hope soon to be in a position to make the recommendations of this group available to politicians and others in an effort to speed their implementation.

Service access is but one of the many issues that government, business and communities need to address to ensure Australia continues to benefit from the opportunities provided by advances in technology and broader economic developments.

For business, another issue is the need to align their strategies, structure and operating models with the demands of a fundamentally changed operating environment.

There is a massive reweighting of investment portfolios as a result of the current surge in interest in high technology stocks.

As yet there does not appear to be any agreed method of valuing or pricing the so called "dot com" stocks.

While that provides a challenge for analysts and investors, I believe the core attributes of favoured stocks will remain the same.

You will need to demonstrate that you have transformed your company to enable it to operate successfully in today's global, competitive and high technology environment.

This transformation needs to be well considered...pervasive...fully integrated and progressive.

It also needs to be underpinned by consistently applied principles and delivered within an equally consistent strategic framework.

This is the approach we adopt at the National – and will continue to adopt.

I know there is considerable interest and speculation about our acquisition and capital management plans.

Let me comment on those.

We have more strategic options than any of our competitors or financial sector colleagues because we have an international spread of assets.

Whatever the outcome of the recently announced mergers, the National will remain Australia's largest bank by market capitalisation...its most profitable major bank...its most efficient in terms of cost/income ratio...and the leader amongst Australian banks and financial services companies in terms of international operations.

So we will continue to be patient...disciplined...and focussed in our consideration of acquisition or alliance options...in Europe, the United States and Australia.

Growth by acquisition, of course, is but one part of our strategy.

Indeed acquisitions, alliances or divestments are simply tactics employed as part of our overall strategy – they are not strategies or objectives in their own right...that point is often lost in market and media analysis of our plans.

While attention continues to be focussed on our aspirations to grow by acquisition...the reality is we have been focussing on streamlining our structure and business operating model to speed organic growth in Australia and overseas.

In essence the National's strategy is this: we want to grow our current profitable lines of business...and we want to attack in those areas we believe will shape the development of financial services in the future.

We are increasing our performance and growth in our businesses that rely on relationship management and the tailoring of financial services.

We are accelerating the growth of businesses such as: wealth management... mortgages... security services... and wholesale financial services where our broad geographic spread and expertise give us a competitive advantage.

We are also rapidly increasing our electronic commerce activities.

We believe that an effective electronic commerce strategy needs to be fully integrated and pervasive throughout all areas of a company's operations.

Our strategy involves three core elements:

- The redesign of basic operating processes
- Fundamental changes in the marketing and distribution of products – the “electronic connectivity” to customers
- Research and development of opportunities for expanded product and service offerings.

One of the electronic commerce implementation problems some of our competitors are starting to encounter is the inability to match “front office” marketing sophistication with “back office” processing capability.

We have invested in both front and back office facilities to the point where we can comfortably manage our needs and others.

During the past year we have spent considerable time assessing the best form of organisational structure and associated operating models to enable us to efficiently manage our various businesses in the New Economy.

We have found that we need to manage current, emerging and future businesses differently.

In effect we have developed a strategic and operating model that is completely aligned with the global, high technology and highly customised requirements of the New Economy.

Summary

Ladies and gentlemen...I believe Australia is currently seeing the impacts of broad economic and technology trends that began well over a decade ago.

What is called the New Economy is neither a miracle nor is it a mirage.

It is simply the economic impact of the widespread application of computing and telecommunications technology.

Its banking and financial services sector is already well advanced in adapting to the new environment.

To achieve the full benefits of this new environment Australia needs to manage a number of challenges.

The most important is the issue of access to the benefits of industry transformation.

We can only address that issue if government, industry and community integrate their efforts.

As the industry leader in “going global” and integrating technology into its operations, the National Australia Bank Group is very confident of its prospects...and those of Australia in the so called “New Economy”.