Trends in Banking and Finance

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It is impossible to predict the future.

This uncertainty applies as much to banking as it does to, say, horse racing.

Yet bankers, like other business people, must take a view of the future.

- We have to take investment decisions where the payoff can be years down the track.

- We have to make choices about new technology without knowing what exciting new developments might emerge next month or next year.

- We have to make judgements about the future economic and financial health of the country despite the fact that economic forecasts are notoriously unreliable.

In these circumstances the best we can do is try to identify and understand those trends most likely to shape the future of our industry. It is an imprecise process, but it is the best we have got.

Today I want to look at some of the trends National Australia Bank believes will influence the banking and finance industry in this country, and to discuss where they might lead us.

I will confine myself to three of the most fundamental of these trends:

- the globalisation of financial markets;

- the onward march of technology; and

- the convergence of financial institutions.

Globalisation

What do I mean by the globalisation of financial markets?

I define globalisation as the growth of cross-border or transnational financial markets. The rise of these markets has been accompanied by the progressive erosion of national financial autonomy.

Global financial markets possess certain important characteristics.

- Global financial markets are not tied to specific geographic locations - they are everywhere, yet nowhere in particular.

- They need no longer be tied to traditional centres of capital accumulation and commercial activity such as London, New York and Tokyo. Market participants might prefer to continue congregating in these centres, but that is another matter.

- Financial markets are essentially outside the jurisdiction of individual nations. Governments can seek to regulate the activities of individual market participants, but they cannot control the markets themselves. This has implications for taxation policy, the enforcement of the law, and so on.

- Financial markets are becoming deeper and more liquid. By this I mean that the amount of money, or the value of the financial instruments traded on these markets, in any given period is increasing.

- The number of market participants is also increasing. However would-be participants face increasingly higher entry barriers in terms of their capital resources, expertise and international affiliations.

- Global markets are throwing up new kinds of risk. Whether these markets are inherently less stable than their more traditional counterparts is a moot point. However some of the risks involved in operating in these markets are not well understood. Managing these risks is one of the big challenges of modern banking.

Some people believe these markets are a kind of global casino, the players in which are all members of an exclusive club of international bankers, financiers and speculators enriching themselves at everyone else's expense.

It is a seductive idea - conspiracy theories usually are - but it simply isn't correct.

The truth of the matter is that governments have always struggled to control international capital flows.

After all, even economists cannot agree on a definition of money, on how it should be measured, let alone on how its supply and its velocity of circulation can be controlled. Trying to regulate international capital flows is like trying to grasp a lump of jelly: the harder you squeeze it, the less you end up with.

The emergence of global financial markets reflects a number of factors.

- The expansion and liberalisation of international trade.
- The international transfer of knowledge and technology.
- The establishment of supranational organisations to facilitate international commerce.
- The rise of transnational business corporations.
- The explosive growth of international travel and tourism.

However, the crucial factor in making global markets a reality has been the breathtaking development of modern information technology and telecommunications.

Technology

Technology continues to have a transforming influence on all aspects of banking and finance.

Technology is:

- redefining our markets;
- reducing our costs (sometimes, anyway);
- lowering the entry barriers to our industry;
- broadening our distribution options;
- allowing us to customise financial products and services;
- freeing our people from the clerical drudgery that was part and parcel of old-style banking.

We know how automatic teller machines and eftpos have already changed the way many people bank. Well, to use a well-worn phrase, "you ain't seen nuthin yet".

Coming up are:

- stored value and so-called "smart" cards;
- consumer and business banking services using personal computers;
- upgraded telephone banking;
- interactive television;
- rechargeable "electronic wallets".

Perhaps the most exciting development is "virtual banking" on the internet.

Just six weeks ago, we launched what we believe is Australia's best internet banking service. It is a leader in terms of features and security. Most importantly, we believe it is the easiest to use of all internet banking services.

It's the outcome of two years of planning, culminating in a nine-month trial with 8,000 users.

In 12 months' time we confidently expect that number to be 100,000. Could it be even higher? Well, we do have one million telephone banking customers and it's highly likely these would be people interested in accessing us through the internet.

In line with our aim of being a global leader in direct financial services, we plan to launch internet banking in New Zealand in the next month or so. Our plans for Europe are under development.

And here in Australia, we are weeks away from giving our business customers access to internet banking.

Another feature that we are very excited about is what we call "pay anyone". By that I mean the ability to transfer funds to other banks simply by typing in the branch number and account number of the recipient. Funds are cleared and settled in real time. This function is in the final stages of testing and is due for release in the third quarter this year.

We see it as the first step to throwing away the cheque book!

We don't believe that's unrealistic when you realise that the Bureau of Statistics says 19 per cent of Australian households - that's nearly 1.3 million homes - already have access to the internet. And the figure is growing at around 50 per cent a year.

Even the familiar automatic teller machine is about to get useful new capabilities. New generation ATMs will process loan applications; accept both cash and cheque deposits; pay bills; issue personalised cheque books; open new accounts; issue insurance policies; and dispense hot and cold drinks. (Well, perhaps not the drinks.)

While ATMs installed in this country might not be equipped with all of these capabilities because of legal constraints. Nevertheless this is what they are capable of. Clearly this kind of technology affects how we distribute our products and services.

Across-the-counter transactions in traditional branches are declining. Experience in America is that while these represented about 40 per cent of all transactions in 1996, the figure will be less than 20 per cent by the Year 2000.

We expect a similar trend in Australia. Already 60 per cent of the National's basic retail transactions are conducted by electronic means.

Take our basic retail account as an example: just 12 per cent of these transactions are conducted face-to-face at a metropolitan branch or 13 per cent at a rural branch.

We estimate that non-traditional bank services will account for about half of the industry's profitability by early next century.

Traditional bank products like deposits and lending will comprise about 40 per cent of Australian financial services in the year 2006. That compares with around 65 per cent today.

But perhaps the most important effect of technology is the way in which it is transforming competitive relativities in banking and finance.

At first, the advent of the information technology age in the 1960s actually protected banks from potential competitors.

The big mainframe computers of this period soaked up large amounts of capital, and few people knew how to operate them effectively.

Combined with the banks' large historical investment in branch networks, this first-wave technology formed a barrier against new entrants to the industry.

Since then the salient feature in the development of information technology has been the astounding change in the cost/performance equation as it applies to succeeding generations of hardware and software.

Today, high-performance and robust banking and financial services systems can be bought off the shelf for quite modest outlays. Operational and support services can be readily outsourced.

Modern banking technology also offers alternative delivery systems to branch networks. Newcomers to the industry need no longer try to replicate bricks-and-mortar networks.

Non-bank financial institutions wishing to offer bank-type services still face a number of obstacles, but technology is not one of them. Indeed technology now helps non-banks invade the banks' traditional turf.

Convergence

This brings me to my third trend, convergence.

Convergence is a term used to describe the process by which the traditional distinctions between banks and other kinds of financial institutions are blurring.

In Australia convergence is already well advanced.

- Fund managers and some of the life offices are increasing their share of financial assets faster than the banks, largely reflecting the growth of compulsory superannuation. For their part, banks are keen to win a slice of this business.

- More generally, life and general insurers, fund managers, stockbrokers, trustee companies, and so on are starting to offer bank-type products and services. Banks are entering - or want to enter - some of these businesses.

- Particularly in the United States, non-financial corporations such as manufacturers, retailers, telecommunications providers, power utilities, and software companies are now offering bank look-alike products. For example, a retailer and a motor manufacturer are two of America's largest credit card issuers.

- Smaller and more nimble financiers are threatening to cherry-pick the most profitable parts of the banks' traditional business. The activities of mortgage originators such as Aussie Home Loans are examples of this process.

Given the powerful forces propelling it, there seems a certain inevitability to convergence.

To a significant degree the future face of banking in Australia will reflect how well our legislative and regulatory framework accommodates the kind of changes I have been talking about today.

Conclusion

Corporate survival demands an ability to foreshadow broad industry trends. Then you need quickly to adopt strategies to take advantage of them.

Our financial services sector has a fundamental challenge. It must continue to provide value for its stakeholders from current strategies and businesses. At the same time, it must make an orderly transition to a new operating environment.

Let me simply say that when faced with major (and perhaps unpalatable) change, we as a community have three choices.

- We can ignore the issues, allowing things to work themselves out, and taking our chances on the ultimate outcome.

- We can circle the wagons, trying to resist change and preserving the status quo.

- We can accept the inevitability of certain changes, seeking to control and direct them towards the most beneficial outcomes for the community at large.

Can there be any real question about the appropriate course of action?

As I said at the outset, the future is inherently unpredictable. This is not the same as saying we are powerless to influence the future.

What we do - or fail to do - will affect the Australian financial system and the broader economy well into the new century.

In turn, these decisions will influence the living standards and financial security of every Australian.

The stakes are high.

Thank you for your attention.