

# CHAPTER 5

## COMPETITION IN THE BANKING INDUSTRY— WINNERS AND LOSERS

### Competition and contestability in the banking industry

5.1 The Wallis report argued that ‘free and competitive markets can produce an efficient allocation of resources and provide a strong foundation for economic growth and development’.<sup>1</sup> Indeed, the language of recent reforms paints an encouraging picture of increased efficiency and better performances by business. The effects of deregulation and the influences of globalisation, however, are mixed—there can be both winners and losers.

5.2 The banking and financial services sector in country Australia has been no exception in that some sectors of the community have benefited from competition while others have not. This chapter discusses broadly the effects of competition on the provision of banking and financial services in regional, rural and remote Australia.

5.3 According to Mr Stan Wallis, his Committee placed a high priority on improving contestability in the system when formulating recommendations to ensure an efficient, responsive, competitive and flexible financial system. By ‘contestability’, he meant ‘the opportunity for newcomers to challenge the established firms and compete with them wherever they see opportunities to do so’.<sup>2</sup> The Wallis Report observed, however, that:

Competition and technology have facilitated the emergence of specialist providers who target products and customers where margins are highest. New entrants (and indeed other exiting competitors) are able to ‘cherry pick’ the attractive products and customers without having to provide complementary services at a loss.<sup>3</sup>

5.4 This tendency to ‘cherry pick’ in the banking industry has meant that while the reforms that have taken place over the last two decades have improved business competitiveness, the effects have not been uniform.<sup>4</sup> Indeed, evidence suggests that

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1 Commonwealth of Australia, *Financial System Inquiry Final Report*, March 1997, p. 177 (The Wallis Report).

2 Stan Wallis, ‘The Future of the Australian Financial System’, *The Sydney Papers*, Autumn, 1997, p. 113 and ‘Modernising our Markets; the Financial System Inquiry’, *CEDA Bulletin*, 1 July 1997.

3 Commonwealth of Australia, *Financial System Inquiry Final Report*, March 1997, p. 142.

4 Graeme Samuel, President, National Competition Council, conceded clearly that ‘while promoting competition will generally improve economic efficiency and community welfare, this may not be the case in specific instances where the benefits of reform would be outweighed

the benefits of competition in the banking industry have been lopsided—that they fall unevenly on sectors of the population with some, notably small rural towns, experiencing a disproportionately negative impact. In other words, there have been sectors of the economy in regional, rural and remote Australia that have prospered under competition while others have struggled.

5.5 The following section considers two sectors in rural Australia where the experiences of competition in the banking industry are very different—agribusiness, where competition is strong and retail banking in small rural towns where competition is weak.

## Agribusiness

5.6 Agribusiness provides an example of a sector in rural Australia where competition in the financial services industry is generating improved services for country people. The KPMG research report, *Small Business Banking in Australia*, found that over recent times, the agribusiness sector in Australia has emerged as one ‘of strong importance to the Australian economy’. According to the report, agribusiness has seen some significant developments in the provision of banking and associated services.<sup>5</sup>

5.7 The involvement of the major banks in this area demonstrates the growing importance of the agricultural sector to them. The National’s Agribusiness Financial Services is a specialist division and is committed to the long-term viability of agribusiness in rural Australia. It informed the Committee that the division consists of over 200 Agribusiness Managers, supported by Agribusiness Analysts located in over 100 regional centres throughout Australia.<sup>6</sup>

5.8 The National explained that agribusiness managers and analysts are specialists with their focus on agriculture and related businesses. They live in the local community and contribute to local community activities and events. Many of the managers are from rural backgrounds and can relate directly to the events that affect agricultural communities.<sup>7</sup> By locating agribusiness in the regional centres, they have direct contact with customers in the region which allows customers one on one access

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by associated costs, or where market failure might warrant regulation.’ Graeme Samuel, President, National Competition Council, ‘A Changing Australia: The Business and Social Imperatives’, presentation to the Institute of Chartered Accountants in Australia, Business Forum 2001, Melbourne, 21 May 2001.

5 KPMG Consulting, *Small Business Banking in Australia*, A Research Report, February 2002, p. 49. In its assessment of the Colonial Ltd and Commonwealth Bank of Australia merger, the ACCC reported in May 2000 that agricultural lending requires a physical presence of some sort. In keeping with this observation, banks and other financial institutions generally have teams of specialist lenders travelling the countryside assessing and managing loan accounts. See *Submission* 105, p. 14.

6 *Submission* 118, p. 8.

7 *Submission* 118, p. 8.

to an agricultural finance specialist. They also understand the time constraints of their customers and regularly travel to their premises (that is, rural properties to conduct interviews).<sup>8</sup>

5.9 The National's Agribusiness Financial Services have grown over the last decade from 20 per cent to just under 30 per cent. This increase is a direct result of the specialisation of the segment and the increasing understanding of agriculture demonstrated by specialised products tailored to meet the needs of agribusiness customers. The bank focuses on recruiting people with farming backgrounds and agricultural training, predominantly from rural Australia.<sup>9</sup>

5.10 As with the other major banks, the Commonwealth Bank outlined the service it offers to the agricultural sector of Australia. It noted that its AGRIOPTIONS package is a complete product, combining lending, investment, risk management, business and personal financial services, designed to provide maximum flexibility and certainty in managing agricultural businesses.<sup>10</sup> Agribusiness also forms an important component of Westpac's Country Business Direct service which has been established in three major regional locations.<sup>11</sup>

5.11 Mr Carroll, ABA, supported the banks in their evidence that agribusiness is an area where banks have targeted their resources. He stated:

Those services have been developed over probably a decade now. Most of the banks servicing that market are employing agriculture graduates and typically they look for agriculture graduates who have a background in family farming so that there is some empathy there. They are delivering the services to the farm—visiting the farm to talk business—rather than the customers having to travel. In that sense, the issue of distance is being addressed. Also they are obviously available to deal with any problems that customers might be having with their banking services. They are generally supported by specialised marketing units.<sup>12</sup>

5.12 Mr Burke, NFF, confirmed the view that the agribusiness had certainly captured the banks' attention. From information obtained from members, Mr Potter, also from the NFF, told the Committee:

...there has been a great improvement in the quality and quantity of agriculture-specific products. More people have been employed. There are

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8 *Submission* 118, p. 9.

9 *Submission* 118, p. 1.

10 *Submission* 124, p. 10.

11 *Submission* 110, p. 4.

12 *Committee Hansard*, 14 November 2002, p. 75.

new agribusiness centres and all that sort of stuff. My impression is that there is some good work being done out there, for farmers specifically.<sup>13</sup>

5.13 He noted further that agribusiness banks are applying themselves to providing mobile banking service. ‘They go out and do trips to catch up with a couple of their clients in a day and that sort of thing. In light of the current banking atmosphere, it is probably on the increase rather than on the decrease’.<sup>14</sup>

5.14 In summary, the NFF noted that agribusiness is seen as ‘a bit of a premium product.’

It is not provided to everybody, and we accept that it will not be able to be provided to everybody. It is still for the select few at the moment.<sup>15</sup>

5.15 Without doubt, agribusiness is a sector where competition in the banking industry has generated improved services. Mr Anthony Harman, Department of Agriculture, Fisheries and Forestry, observed ‘with a lot of farmers, because they have such big debts and outstanding loans, there is fairly strong incentive for the banks to service them to the level of their satisfaction’.<sup>16</sup>

5.16 It should be noted, however, that even within this sector, there are groups more valued than others. One industry commentator observed:

It is not surprising given the polarisation in the financial performance of the farm sector that lenders have analysed in detail the revenues generated from clients and aligned both their product mix and level of servicing accordingly. At the ‘bottom end’ of the farm sector, where the finance needs are both simple and low volume, servicing via generic lending products and centralised telephone service centres is the only way in which lenders can deliver services profitably. At the other end, the product mix options provided are more sophisticated and are supported by personalised account management.<sup>17</sup>

## **Retail banking transactions in country Australia**

5.17 Although there is robust competition within certain sectors of the financial service sector in rural and regional Australia, there are areas of service provision that are not driven by competition—where the market is sluggish in responding to consumer needs. Basic retail banking transactions is one such area.

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13 *Committee Hansard*, 14 November 2002, p. 56.

14 *Committee Hansard*, 14 November 2002, pp. 56–7.

15 *Committee Hansard*, 14 November 2002, p. 57.

16 *Committee Hansard*, 12 November 2002, p. 4.

17 Bruce Brown, ‘Future rural finance trends’, paper included in vol. 2 of the proceedings of the National Outlook Conference, *Outlook 2001: capturing growth opportunities*, Canberra, 27 February–1 March 2001. See also Evan Jones, ‘Rural Finance in Australia: a Troubled History’, *Rural Society*, vol. 12, no. 2, p. 171.

5.18 In looking specifically at the banking industry, a study by the Productivity Commission in 1999 found that there were pockets of the Australian community that had not gained from competition in the banking sector:

Bank branch closures have been part of the decline of some small country towns. The spread of newer bank technologies and the deregulation of the financial system have reduced the demand for and supply of traditional banking services and seen the emergence of new financial services and new ways of providing traditional services. While benefiting many, it has disadvantaged some, particularly people reliant on traditional banking services in those small rural communities where all branches have been closed and only of limited range replacement services have emerged.<sup>18</sup>

5.19 Conclusions reached by the ACCC in 1998 and 2000 support the contention that banking deposits and retail transaction accounts may be one such area where deregulation has not produced sturdy competition. In considering the merger proposal of Westpac and the Bank of Melbourne and the proposed merger of the Commonwealth and the Colonial, the ACCC was concerned about competition for transaction accounts, deposit products and small and medium-enterprise banking.<sup>19</sup>

5.20 It found in the case of the Commonwealth/Colonial merger that the Commonwealth acquisition of Colonial would likely cause a substantial lessening of competition in five markets—transactions accounts, deposit products and small business banking in Tasmania and transaction accounts and small business banking in regional New South Wales.<sup>20</sup>

5.21 In further support of these findings and consistent with the evidence presented in chapter 3, Mr Chris Connolly and Mr Khaldoun Hajaj found that:

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18 Productivity Commission, *Impact of Competition Policy Reforms on Rural and Regional Australia*, Inquiry Report, no. 8, 8 September 1999, p. xxxvii.

19 The ACCC found in the case of the Commonwealth/Colonial merger that there was little evidence that suppliers of transactions accounts who had minimal branch, agency or ATM network infrastructure could provide a competitive constraint. Pure on-line banking had tended to target technologically sophisticated consumers but for most consumers, on-line banking offered few substitution possibilities.

In the deposits market, the Commission took the view that ‘the apparent lack of demand side substitutability between at call transactions accounts and longer term savings type products led to the conclusion that there was a separate market for deposits’. In the Commission’s view, ‘barriers to entry in this market were substantial. New entrants would need to develop a branch network and establish a trusted and identifiable brand name. Independent reports indicated that Internet-only banks had made little headway and that access to “bricks” rather than just “clicks” was important’. Ross Jones, Commissioner, Australian Competition and Consumer Commission, ‘The Dollars and Sense of Bank Consolidation, Bank Mergers and the Trade Practices Act ...’, Melbourne Business School Current Issues Conference, Melbourne, Friday, 12 April 2002, p. 12.

20 *ibid.* See also *Forum*, ACCC Journal No. 40. pp. 19, 20. and Tom Valentine and Guy Ford, ‘Bank Mergers in the Australian Financial System: Should the Pillars be Pulled Down?’, *Economic Papers*, 1 December 2001, vol. 20, no. 4, pp. 45–6.

Australia has one of the most concentrated banking markets in the world...despite the level of concentration, there are some areas of reasonable competition, such as the home lending market. However, everyone from the Australian Competition and Consumer Commission (ACCC) to the Prime Minister agrees that the areas of weakness in bank competition are retail transaction accounts and small business banking.<sup>21</sup>

5.22 Mrs Zerst, Secretary, Nanango Progressive Community Ltd, encapsulated the views of many community leaders trying to improve banking services to their areas, 'it is quite common knowledge that the large banks like the National Bank here really do not care if their customers leave, as long as their business customers do not leave'.<sup>22</sup>

5.23 Thus, while a retail network in the banking industry may be important to customers for the delivery of transaction and term deposits, the relatively high operating costs associated with traditional bank branch services renders this approach to retail banking unattractive for both incumbents and potential new entrants.<sup>23</sup> In many instances, the small country town is a low value market that banks have chosen to jettison.

5.24 Put succinctly by the Hindmarsh Shire Council:

Sometimes it seems that the major banks are in a race, to avoid being the last branch in town.<sup>24</sup>

5.25 Professor Ian Harper took a pragmatic approach to the future of banking worldwide and in Australia. He stated bluntly that banks do not need rural branches, they are 'too expensive'.<sup>25</sup> He told the Committee:

I would be less saying to the people who are departing: 'Stop! Stop! Come back here. Get back to your posts.' That is Canute-like. It is not because the banks, in my opinion, are seeking to be antisocial. They are responding to forces which are very strong and my concern is that they be allowed to respond to these forces, because the consequences of not doing so are severe. Instead I suggest asking, 'Right. What fills this space when the banks have departed, and can we as representatives of the public do

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21 Chris Connolly and Khaldoun Hajaj, *Small Business Banking: Issues Paper*, Financial Services Consumer Policy, University of New South Wales, April 2002, p. 7.

22 *Committee Hansard*, 22 May 2003, p. 485.

23 Garry Goddard and Greg Walker, *Bank Mergers in Australia: Competition Assessment of the Commonwealth Bank of Australia's Acquisition of Colonial Limited*, Working Paper no. 2/01, April 2001, p. 26.

24 *Submission* 87, p. 1.

25 *Committee Hansard*, 26 February 2003, p. 237.

something, if necessary, through the public mechanisms to assist to catalyse the development of what comes afterwards?’<sup>26</sup>

He warned that there were difficult times ahead for the banking industry and adjustments would not be smooth—that the market was not going to be flawless in this transition.

## **Conclusion**

5.26 Most witnesses accept that banking, like the rest of society, has changed and cannot go back to old ways. Nonetheless, it is a matter of concern to the Committee that there are pockets in the Australian community where competition in the retail banking industry is not strong and where the withdrawal of bank branches has created a void in the provision of banking and financial services. Evidence presented in chapter 3 suggests that the market has been slow to respond to the withdrawal of traditional bank services and is causing problems for some groups in country Australia.

5.27 The Committee is very interested in the question posed by Professor Harper—‘What fills this space when the banks have departed?’ The following chapter looks at the way in which service providers have moved into the vacuum left by the closure of bank branches in regional, rural and remote Australia and overall how they are meeting the challenge of delivering banking and financial services to country people.

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26 *Committee Hansard*, 26 February 2003, p. 239.

