

## Chapter 2

### Background - the Australian banking market

#### A history of strong banks in Australia

2.1 Banking in Australia has a history spanning almost two centuries and for at least the latter century the core banking system has proved itself one of the strongest and most resilient in the world.<sup>1</sup> As the Australian Bankers' Association pointed out:

This stands in contrast to many other countries. For example, since the 1890s depression... there is only one example of bank depositors losing money in an Australian bank, and that was a small rural bank in the 1930s when the depositors lost one cent in the dollar. In our research we have found no example of when taxpayers' money has been used to bail out any Australian private bank.<sup>2</sup>

2.2 This long-term strength has owed a lot to the regulation and supervision of the banks by the authorities. It has been notable that the collapses and near-collapses of financial intermediaries have occurred among the unregulated non-bank intermediaries.<sup>3</sup>

2.3 In the current global financial crisis, in a number of countries large banks have had to be 'rescued' by governments injected equity, making emergency loans or even (temporarily) nationalising them. By contrast, none of these measures have been necessary in Australia. The four major Australian banks now constitute four of only eleven among the world's largest 100 banks which are rated AA or better.<sup>4</sup>

2.4 The Government has implemented schemes to guarantee deposits up to \$1 million, and offered to guarantee, for a fee, larger deposits and wholesale funding. This was arguably necessary to match similar measures by foreign governments. Views differ about whether the scheme has helped or hindered the smaller banks. As the guarantees are the subject of a separate inquiry by this Committee, they are not discussed further in this report.<sup>5</sup>

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1 A brief history of banking in Australia can be found in Chapter 2 of House of Representatives Standing Committee on Finance and Public Administration (1991).

2 Mr Nicholas Hossack, ABA, *Committee Hansard*, 12 March 2009, p 1.

3 Examples include 'merchant banks' such as Tricontinental, Nugan Hand, and Rothwells; Pyramid Building Society (in the period before building societies were supervised by APRA), and finance companies such as FCA.

4 Reserve Bank of Australia, *Financial Stability Review*, March 2009, p 25.

5 The report *Government measures to address confidence concerns in the financial sector – The Financial claims Scheme and the Guarantee Scheme for Large Deposits and Wholesale Funding*, was tabled on 17 September 2009.

2.5 Views differ about the reasons for the recent relative strength of the Australian banking system. The banks themselves regard it as a vindication of good management. The supervisors believe it reflects their good work. There is some truth in both these views; Australian banks have largely eschewed the practices such as 'low doc' and 'no recourse' lending which generated large bad debts in the domestic lending of American banks. There was also an element of good luck. As Australia is a net borrower, banks here were concentrating on raising funds overseas to lend in Australia. This meant that unlike countries which generated excess savings, Australian banks were not looking to buy foreign securities, many of which had a complexity which disguised their low quality.<sup>6</sup>

### Concentration in the Australian banking market

2.6 Four large banks now dominate the Australian banking market, accounting for around three-quarters of deposits and assets and a larger share of home loans (Table 2.1, last row). They have each reached this position through a succession of mergers over the past 150 years (see the 'family trees' in Charts 2.1 to 2.5).<sup>7</sup>

**Table 2.1: Measures of concentration in the Australian banking market**

	Assets		Deposits		Home loans	
	Share of 4 largest banks	HH index <sup>1</sup>	Share of 4 largest banks	HH index <sup>1</sup>	Share of 4 largest banks	HH index <sup>1</sup>
1890	0.34	.06				
1913	0.38	.10				
1950	0.63	.14	0.64	.15		
1970	0.68	.16	0.68	.16	0.77 <sup>2</sup>	.21 <sup>2</sup>
1990	0.66	.12	0.65	.12	0.65	.13
Oct 2008 (pre-mergers)	0.65	.11	0.65	.12	0.74	.15
Oct 2008 (post-mergers <sup>3</sup> )	0.73	.14	0.75	.15	0.86	.20
July 2009 <sup>3</sup>	0.74	.15	0.78	.16	0.90	.27

<sup>1</sup>The Herfindahl-Hirschman concentration index (which can vary from 0 representing perfect competition to 1 representing monopoly; a market with X equally-sized competitors will have an index of 1/X). <sup>2</sup>Assuming all owner-occupier housing loans were made by savings banks and accounted for all their loans. <sup>3</sup>Counting Adelaide, BankWest and St George as parts of Bendigo, Commonwealth and Westpac respectively.

Source: Secretariat, calculated from data in APRA, *Monthly Banking Statistics*, October 2008, July 2009; *RBA Bulletin*, June 1990; Butlin et al (1971), White (1973).

6 See Macfarlane (2009) for an elaboration.

7 To keep the trees legible, some small savings banks and building societies have been omitted.

2.7 For example, Westpac was formed from the 1982 merger of the Bank of New South Wales and the Commercial Bank of Australia. Since then, Westpac has acquired the Challenge Bank (1995), the Bank of Melbourne (1997), BT Financial Group (2002) and, in December 2008, St George Bank Ltd (which itself started as a building society and amalgamated with a number of smaller banks, including Advance Bank in 1997 and BankSA).

2.8 Indeed, the big four banks have essentially grown their market share over the past century by successively taking over the various banks and building societies established in the previous century – other than the Commonwealth Bank (only established in 1912), the increases in their market share are more than accounted for by their acquisitions (Table 2.2). There are now few smaller banks left for them to take over, so they will face the novel challenge of having to compete among themselves for market share in coming years.

**Table 2.2: Major banks: increases in market share, role of acquisitions**

	July 2009: % share of total bank assets	1913: % share of total bank assets of predecessor	Change (% points)	1913: % share of total bank assets of banks subsequently acquired
Commonwealth <sup>1</sup>	23	2 (Commonwealth)	+21	11
Westpac <sup>2</sup>	21	13 (Bank of New South Wales)	+8	7
NAB	16	5 (National Bank)	+11	18
ANZ	14	6 (Bank of Australasia)	+8	15
Sum of above	74	26	+48	51

Source: Secretariat, calculated from data in APRA, *Banking Statistics*, July 2009 and Butlin et al (1971).

<sup>1</sup>Counting BankWest as part of Commonwealth. <sup>2</sup>Counting St George as part of Westpac.

2.9 A consequence of these mergers has been a long-run tendency towards increased concentration within the Australian banking industry (Table 2.1). There was a temporary reduction in concentration with the deregulation of the 1980s, mostly reflecting the entry of foreign banks and conversion of the larger building societies, but this has now been overwhelmed by the ongoing mergers. As a result the

Australian banking market is now, by some criteria, the most concentrated it has been for more than a century. This is a greater concern at a time when the global financial crisis has markedly reduced the ability of non-bank financial institutions to compete with the banks.<sup>8</sup>

2.10 There is a long history of concern about inadequate competition in Australian banking, well before the mergers of the past decade. In 1932 former treasurer 'Red Ted' Theodore led a committee which pointed out that a handful of banks possessed 90 per cent of business in 'a virtual money trust'.<sup>9</sup> In 1991, the Martin Report commented:

...the emergence of four major banks in Australia over the past decade has indicated a trend towards greater concentration in the banking industry...The concerns which exist among various sections of the community about the trend towards increased concentration in the banking industry are shared by the Committee.<sup>10</sup>

2.11 The Australian banking market is now quite concentrated by international standards (Tables 2.3 and 2.4).<sup>11</sup> This is likely to be one reason it is more profitable, and has wider interest margins, than banks in most comparable countries, although this also partly reflects that it has fewer non-performing loans. Operating costs are not especially low. An international comparison shown in Table 2.3.

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8 See House of Representatives Standing Committee on Economics (2008).

9 Theodore et al (1932, p 9). A history of Australian banking is given in Chapter Two of House of Representatives Standing Committee on Finance and Public Administration (1991); see especially paragraphs 2.29, 2.41, 2.86, 2.87 and 2.93 on mergers. Chapter Eight is also relevant.

10 House of Representatives Standing Committee on Finance and Public Administration (1991, pp 120, 127).

11 This conclusion is also reached by House of Representatives Standing Committee on Economics (2008, p 26).

**Table 2.3: Aspects of banking markets, 2008**

	Concentration measures, 2008 (based on assets) <sup>1</sup>		Profitability of major banks (per cent of assets)				Major banks' non-performing
	% share of 4 largest banks	HH index <sup>2</sup>	Pre-tax profits	Loan loss provisions	Net interest margin	Operating costs	loans: per cent of total assets
Australia	84	.19	1.0	0.3	1.7	1.5	0.3
Canada	76	.17	0.5	0.2	1.4	2.0	0.4
France	82	.21	0.1	0.2	0.7	1.2	1.0
Germany	47	.10	-0.4	0.2	0.6	1.2	0.4
Japan	57	.10	0.1	0.2	0.5	0.7	1.0
Netherlands	97	.33	-0.8	0.3	1.0	1.3	0.9
Sweden	99	.30	0.7	0.1	1.0	1.0	0.5
Switzerland	82	.32	-1.9	0.1	0.5	2.6	0.3
UK	84	.21	-0.1	0.4	0.8	1.3	1.1
United States	<59	<.10	0.4	1.1	2.2	3.4	1.0

<sup>1</sup>Only includes domestically-headquartered banks which rank in the world's top 1000. In Australia this includes nine banks accounting for 80 per cent of the market. <sup>2</sup>The Herfindahl-Hirschman concentration index (which can vary from 0 representing perfect competition to 1 representing monopoly; a market with X equally-sized competitors will have an index of 1/X). Sources: Secretariat, calculated from data in *The Banker*, July 2009; Bank for International Settlements (2009, p 39).

**Table 2.4: Concentration in banking markets: assets held by 5 largest banks (per cent of total assets)**

	1980	1990	1999
Australia	77	72	74
Belgium	53	48	72
Canada	n.a.	60	77
France	n.a.	52	69
Japan	29	32	30
Netherlands	n.a.	74	82
Spain	38	38	47 <sup>1</sup>
Sweden	n.a.	62	84 <sup>2</sup>
Switzerland	n.a.	53	58 <sup>1</sup>
United Kingdom	n.a.	44	35
United States	14	11	27

Source: Group of Ten (2001), data annex B. <sup>1</sup>1997 <sup>2</sup>1998

***Is Australia overbanked?***

2.12 Mergers make more sense if Australia is currently 'overbanked'; if it now has an excessive number of bank branches. Australia does have more banks and branches relative to its population than many other developed economies (Table 5). But allowance must be made for the dispersed population of Australia: a single branch in Kowloon would be within a reasonable distance for the six million residents of Hong Kong, but a branch in Sydney (or even Perth) is not much use for a customer in Karratha.

**Table 2.5: Deposit-taking institutions\* in advanced economies, c2000**

	DTIs per million persons	DTI branches per million persons
Australia	18	321
Euro area	23	557
Hong Kong	42	261
Japan	5	180
Singapore	69	160
Switzerland	56	471
United Kingdom	9	242
United States	79	288

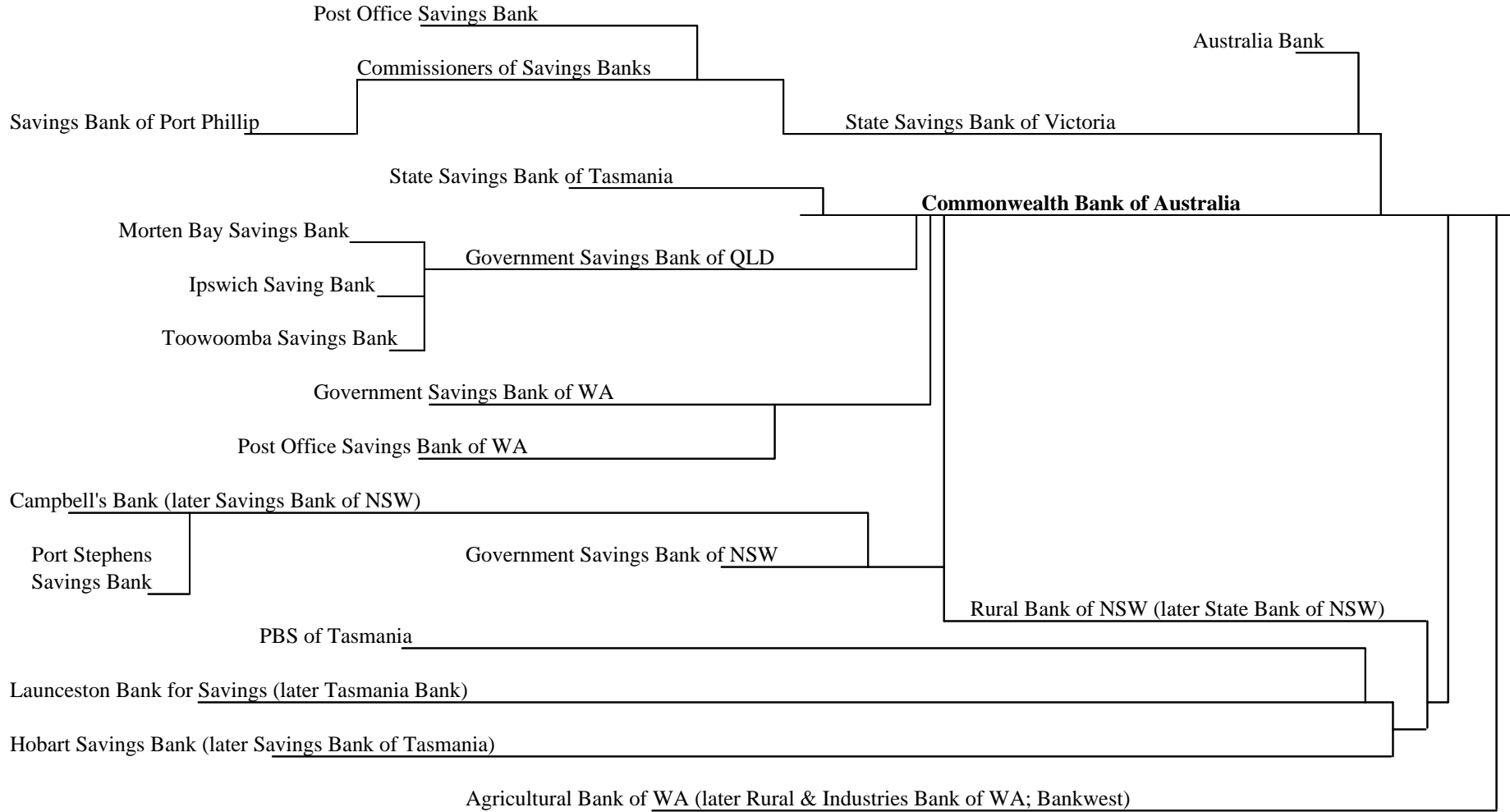
\*DTIs include commercial, savings and various types of mutual and cooperative banks, and similar intermediaries such as building societies, thrifts, savings and loan associations, credit unions and finance companies, but *excludes* insurance companies, pension and superannuation funds, unit trusts and mutual funds.

Source: Hawkins and Mihaljek (2001).

# Chart 1: Australian Banks Family Tree

## I. Commonwealth Bank of Australia

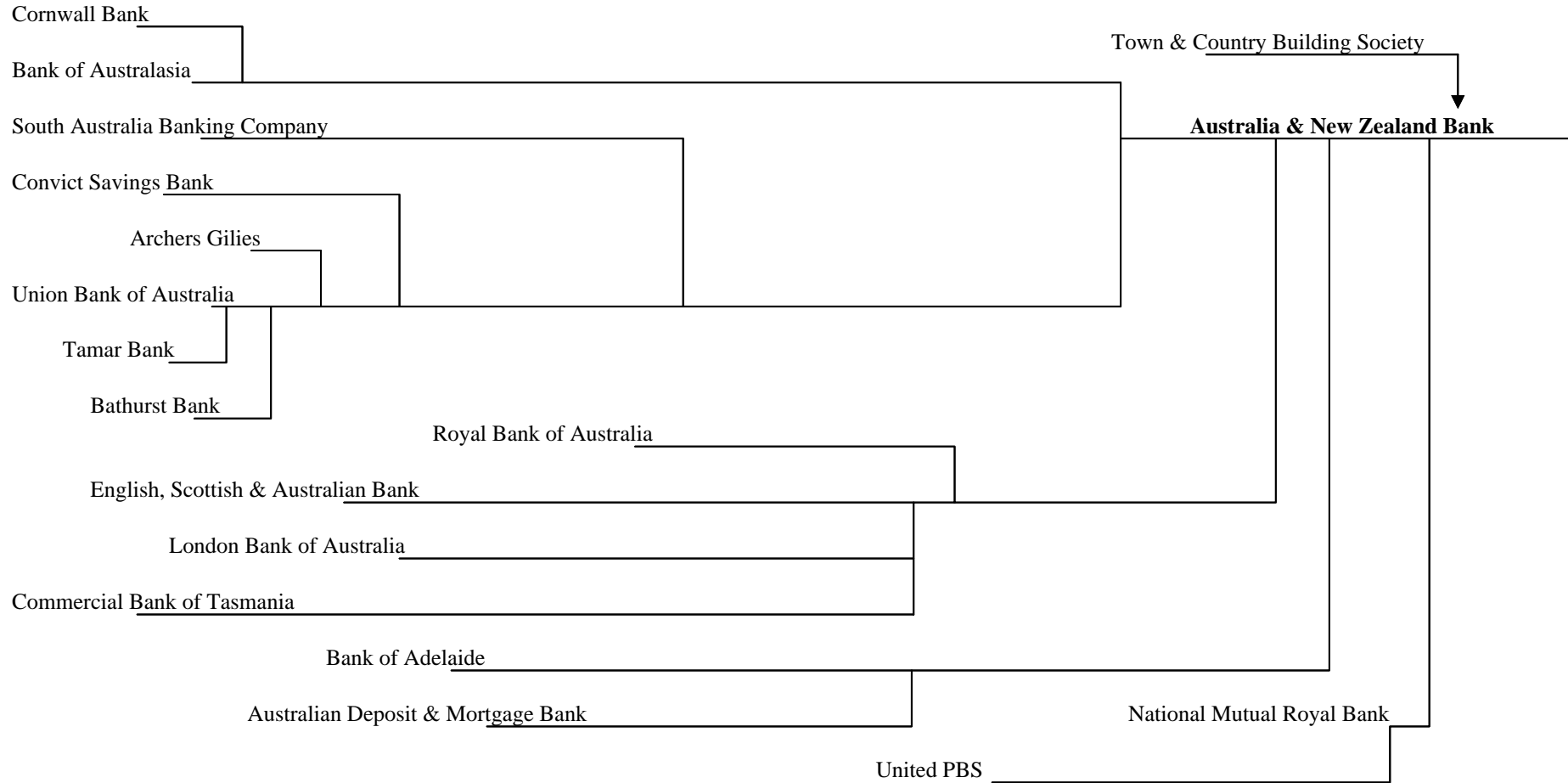
1810's 1820's 1830's 1840's 1850's 1860's 1870's 1880's 1890's 1900's 1910's 1920's 1930's 1940's 1950's 1960's 1970's 1980's 1990's 2000's



## Chart 2: Australian Banks Family Tree

## II. ANZ Bank

1810's 1820's 1830's 1840's 1850's 1860's 1870's 1880's 1890's 1900's 1910's 1920's 1930's 1940's 1950's 1960's 1970's 1980's 1990's 2000's

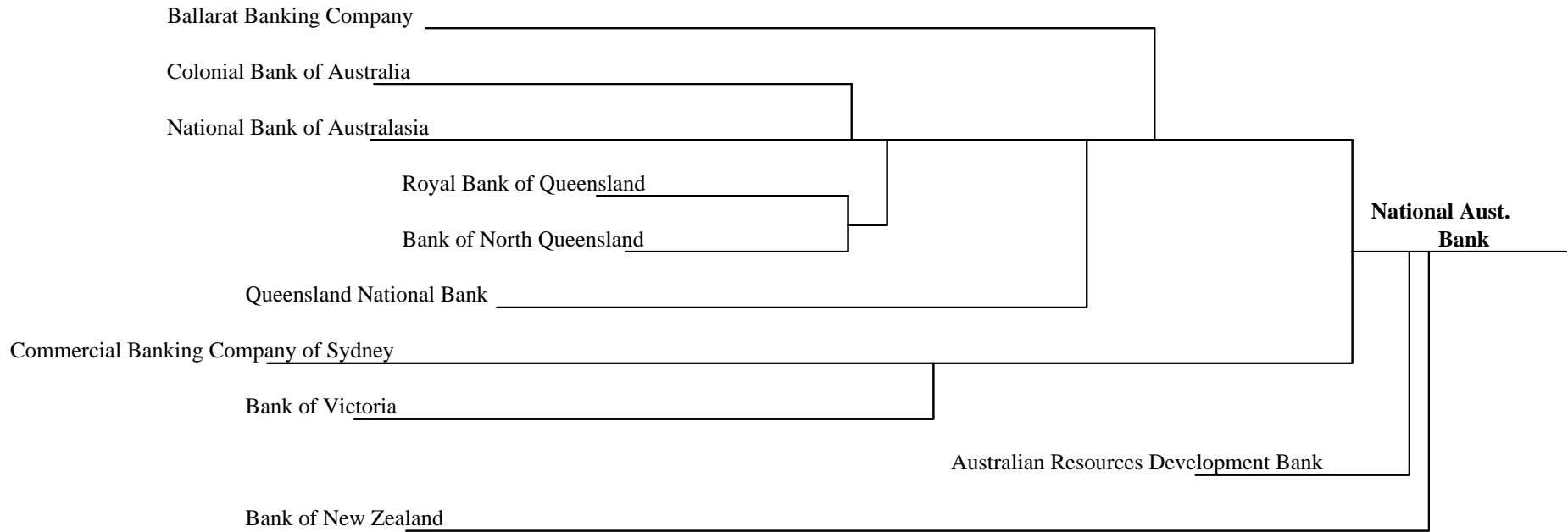




### Chart 3: Australian Banks Family Tree

### III. NAB

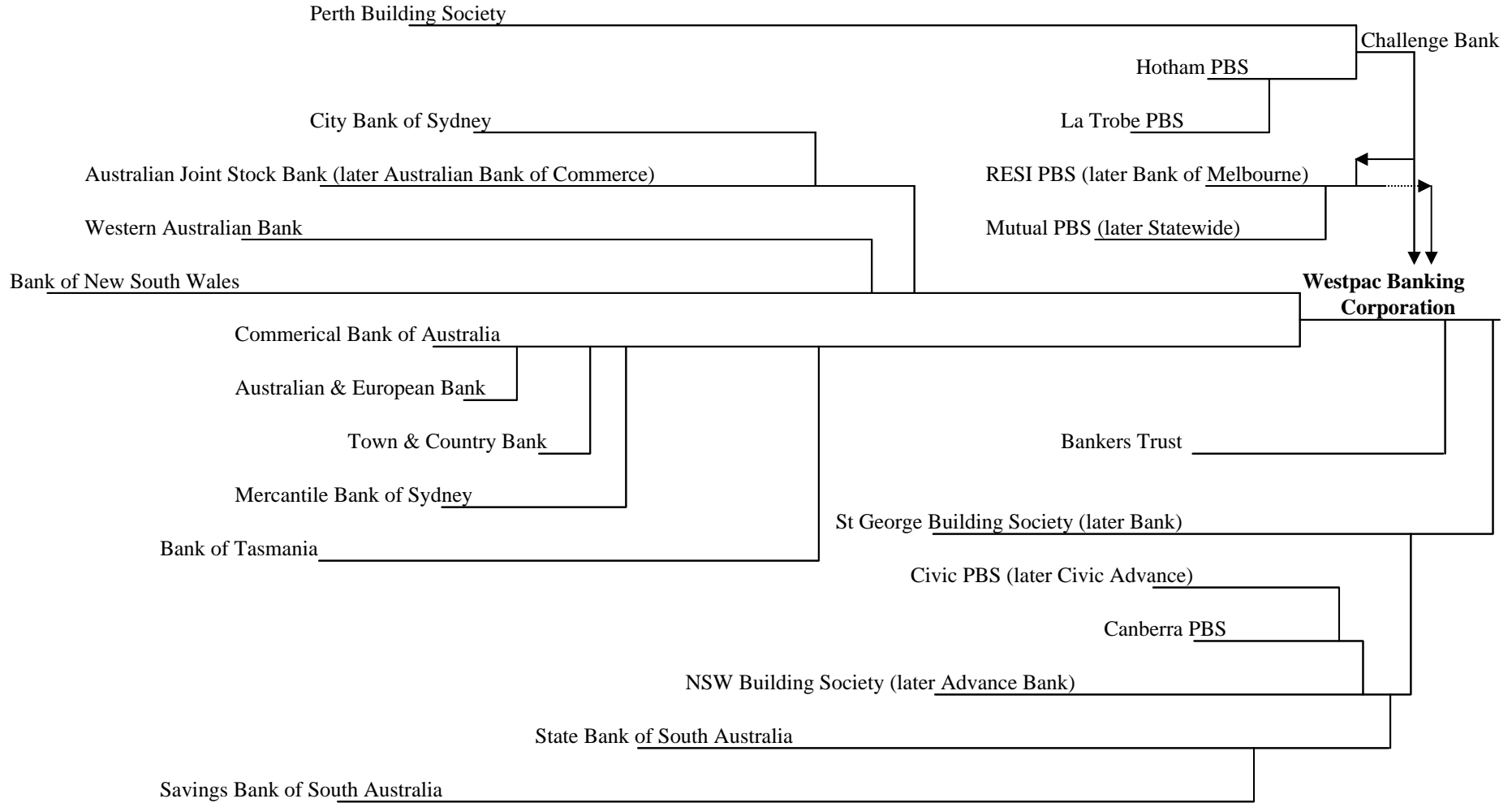
1810's 1820's 1830's 1840's 1850's 1860's 1870's 1880's 1890's 1900's 1910's 1920's 1930's 1940's 1950's 1960's 1970's 1980's 1990's 2000's



# Chart 4: Australian Banks Family Tree

## IV. Westpac

1810's 1820's 1830's 1840's 1850's 1860's 1870's 1880's 1890's 1900's 1910's 1920's 1930's 1940's 1950's 1960's 1970's 1980's 1990's 2000's



## Chart 5: Australian Banks Family Tree

### V. Other

1810's 1820's 1830's 1840's 1850's 1860's 1870's 1880's 1890's 1900's 1910's 1920's 1930's 1940's 1950's 1960's 1970's 1980's 1990's 2000's

