Shareholders: An unexplored opportunity for Australian financial institutions
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Shareholders: An unexplored opportunity for Australian financial institutions

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Abstract While Australian financial institutions have recognised for many years the need to segment their customer base and develop niche marketing strategies, those that are listed on the Australian Stock Exchange appear to have ignored a substantial and powerful pool of potential customers — their shareholders. This paper reviews the shareholder marketing strategies adopted by 12 listed Australian banks and building societies. It looks at the cost of customers, the value of converting shareholders to customers and reviews the shareholder loyalty programmes being offered. This paper argues that banks in Australia are ignoring this important pool of potential customers. The author develops the view that the banks and building societies have failed to maximise shareholder value as they have few processes in place to target this important sector.

Keywords Shareholders, customer value, Australian banks, cost of customers, shareholder loyalty, shareholder value

SCOPE AND TERMINOLOGY

Australia follows the Standard & Poors Global Industry Classification Standard (GICS) for listed companies. The Australian Financial Institution Sector is divided into six categories: Banks, Consumer Finance, Diversified Financial Resources, Multi-Sector Holdings and Insurance. This paper focuses on the Bank category, which comprises eight banks and four building societies. (Table 1). To make the report flow, 'bank' refers to both banks and building societies.

INTRODUCTION

In the post-deregulation era, Australian banks appear to have forgotten the changing demographics and socio-economic condition of their customers. Gone are the days when customers would have only one banking relationship. Increased competition from a plethora of new entrants, the continued aftermath of banking deregulation and the high lending interest rates of the early 1990s have seen to that. Years of cost cutting, mergers and other internally focused activities have resulted in the commoditisation of banking services. The result is that, from a customer's point of view, there is little perceived difference between financial institutions with local, regional or national markets.

To the banks' detriment a large number of customers have become shoppers who view banks as providers of single services, rather than companies wanting to build a relationship that provides a complete

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Table 1 Financial institutions reviewed

Institution	*Customer base derived from*	*Background*	*Listing year*	*Market capital A$m (Dec 04)*	*No. of shareholders 2004*
Adelaide Bank	South Australia	Merger of a building society and credit union	1992	972	23,265
Australia New Zealand Bank	National	Full service bank, base in Victoria	1969	36,761	252,072
Bank of Queensland	Queensland, increasing branches in New South Wales and Victoria	State-based bank using franchises to increase branch network in other states	1971	1,008	33,403
Bendigo Bank	Victoria, moving into rural centres nationally	Collection of community-based banks; local banks owned by communities	1985	471	47,332
Commonwealth Bank	National, originally government owned	Originally owned by federal government largest branch network	1991	40,153	714,492
Home Building Society	Western Australia	Mutual organisation	2002	93,154	6,846
Mackay Permanent Building Society	Regional Queensland	Mutual organisation	2000	24,604	663
National Australia Bank	National	Full service bank, base in Victoria	1974	44,707	385,506
Rock Building Society	Regional Queensland	Mutual organisation	1992	61,116	3,164
St George Bank	New South Wales, increasing presence in other states	Credit union	1992	12,730	122,128
Westpac	National	Full service bank, base in New South Wales; oldest Australian bank	1970	33,790	225,646
Widebay Building Society	Regional Queensland	Mutual organisation	1994	137,934	2,637

Source: Australian Stock Exchange and company websites

banking solution. Aided by the federal government's drive to introduce compulsory superannuation, retail banking customers are changing their banking habits. With working Australians now having to fund their retirement their relationship to savings and investment is changing.

Moreover, the Australian economy, over the past decade, has experienced a sustained period of growth, seemingly inured to the trends and problems of Asia and USA. Combined with the focus on compulsory superannuation the Australian investment market is awash with money. This is confirmed by the Australian Stock Exchange 2003 Share Ownership Study which shows that 51 per cent of Australia's adult population (7.4 million) own shares either directly or indirectly through a managed fund or self-managed superannuation fund. Further, since 2002 the average portfolio value has increased 14 per cent to A$40,800.[1]

GROWTH

While Australian banks have been very successful in demonstrating growth in 'shareholder value', the same cannot be said

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for their relationship with their customer/shareholder base. The fallout from the deregulation of the Australian banking sector has resulted in a deep-seated cynicism about banks. In 1983, just 6 per cent of Australians surveyed thought banks were 'doing a poor job for Australia'. As the impact of deregulation was felt, however, with the subsequent increase in fees, and when the property market crashed in the early 1990s, attitudes changed. By 1992, 48 per cent of those surveyed thought banks were doing a poor job. Despite a concerted effort on all fronts to improve the image of the banks, by 2000 44 per cent still did not approve of banks.[2] The continuation of these attitudes has allowed into the market a number of new entrants with the ability to be selective in the services they offer. This competition has exacerbated the banks' needs to continue to produce substantial profits to maintain growth in shareholder value.

Essentially, there are four ways a retail bank can grow its revenues:

- Derive more fees from its customer base
- Reduce delivery and service costs
- Acquire new customers via mergers and/or acquisitions
- Attract new customers from other banks and/or increase the retention rate of its customers.

Retail banks made some serious mistakes when in the reaction to high interest rates and the poor lending practice of the early 1990s they opted to focus on the first three options. The collective focus by all banks on structural changes and the implementation of technology-driven projects failed to consider the broader implications of the ultimate outcome: a pool of highly cynical customers.

More fees

Under the banner of 'user-pays', banks significantly increased the fees charged for the services they provided over the past decade. Examples range from the introduction of 'over-the-counter transaction' fees, to withdrawal fees if using another bank's ATM network, to additional fees for using a credit card. The problem is that with every introduction of new charges the banks opened the doors to new competitors who have none of the cost base or long-term baggage that surround the established bricks-and-mortar banks.

Reduce costs

Technology in its many forms has been a major agent of change in altering retail customer behaviour. The problem is that by reducing the human element, however, technology further commoditises banking services. It becomes a double-edged sword because even though technology lowers transaction costs, it reduces the barriers to entry for non-banking institutions.

In 2004, the cost of income for five major banks (including St George) increased and non-interest income as a proportion of total income decreased, which indicates that significant cost savings and revenue initiatives are becoming harder to find. Combined with the continued decline in interest margins, this leads to the conclusion that the only way to maintain profitability and growth at historic levels will be to increase market share.[3]

Acquire new customers by merger or acquisition

Deregulation was supposed to increase competition by creating a more efficient system that offered better opportunities for savers as well as lower costs for borrowers. The late 1980s and early 1990s, however, saw the four major banks (Commonwealth Bank, Australia and New Zealand Bank, The National Bank

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and Westpac) merge with or acquire almost every state-based bank. The long-term impact of the reduction in competition has been a rise in customer activism and the reluctance of the Australian Federal Government to endorse the merger of any of the four major banks. The central problem is that deregulation did not deliver increased competition simply because the concentration made entry difficult for new competitors. This was particularly apparent during the dot com era when, unlike in Europe and the USA, no internet banks were launched.

New customers and increasing retention rates

The Australian banking sector is already highly competitive as a result of the small population base of 21 million and the fact that since the late 1990s Australia's population is growing by just over 1 per cent. The real sting is in the 2003 forecast by the Australian Bureau of Statistics (ABS) that this trend will only continue for the next 4–15 years because without an increase in net overseas migration to compensate, Australian population numbers will actually decline.[4]

The underlying reason why banks want to build a relationship with customers is an economic one. Fundamentally, banks generate better shareholder value/returns when they work to win new and/or retain their most profitable customers because they deliver two important benefits. First, there is a reduction in marketing costs, as fewer dollars need to be spent replacing new customers. Secondly, as the relationship lengthens a bank ideally should understand its customers' requirements better. At the same time customers understand what their bank can do for them, and the banks become better equipped to identify and satisfy their customers' requirements profitably.

CUSTOMER RELATIONSHIPS

In the last two decades, competitive interest rates, lower account fees and other incentives engineered to acquire new customers have resulted in even the most loyal of customers shopping around to find the best products with the lowest fees or highest returns. The problem that banks have created for themselves is that they have done little to build meaningful relationships with their customers. The banks, of course, will argue differently, pointing to various relationship structures and management processes, yet, outside the introduction of private banking, which aims to build an all-encompassing relationship with high net worth individuals (HNWI), they have continued to ignore the main retail base.

The KPMG 2003/04 report into financial institutions' performance comments on the status of the wealth management business of the banks, stating that 'investors are smarter and more demanding . . . they are typically less loyal customers . . . and will switch when they perceive greater value elsewhere.'[5]

Profitable customers

One of the major trends in evaluating the value of a customer is to look at their lifetime value. The agreed profile of a profitable customer is one who holds a range of accounts with the bank. Ideally, the customer would have a mortgage, a credit card and even a personal loan, supported by a high-value cheque account and some additional savings accounts. The problem with this model is that it does not take into account the ability of the customer to influence other customers' banking decisions (company banking, company and/or staff superannuation funds, insurance, broking etc). This shortsighted approach to 'whole of wallet' customer management is seen at all levels of Australia's retail banks.

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Table 2 Effect of customer retention on customer base

Year	Bank A 95 % customer retention			Bank B 90% customer retention		
	Existing base	New customers	Total customers	Existing base	New customers	Total customers
2000	1,000	100	1,100	1,000	100	1,100
2001	1,045	100	1,145	990	100	1,090
2002	1,088	100	1,188	981	100	1,081
2003	1,129	100	1,229	973	100	1,073
2004	1,168	100	1,268	966	100	1,066

Cost of winning new customers

There are vast amounts of research that attempt to quantify the true cost of acquiring new customers. Almost every business has to invest money up front to attract new customers. Most of these costs are easily identifiable: advertising directed at new customers, commissions, sales force overheads, direct mail etc. Additionally, there are many hidden costs such as back-office costs to process the applications. The reality is that the number is higher than management expects. The St George Bank quotes an acquisition cost of eight to ten times higher than the retention cost.[6]

The major advantage the banks have is that the services they offer are not one-off purchases. A customer opening an account whatever the type is making a commitment for some period of time. So the longer the bank can keep a customer the longer it can continue to generate revenues. Good stable customer relationships mean predictable revenues and subsequently, profit streams become more secure.

Increasing customer retention rates

Reducing the rate of defection of customers naturally increases the revenue base of a company. Table 2 compares two banks: Bank A has a customer retention rate of 95 per cent and Bank B has a customer retention rate of 90 per cent. So if both banks start from an identical customer base and add the same number of new customers each year, after four years Bank A will have 19 per cent more customers than Bank B.

Additionally if this model is extended to 14 years, the customer retention rate of Bank A translates to a doubling of the customer base of Bank B. If the retention differential is increased by ten percentage points the customer base of Bank A doubles in seven years. Therefore, banks need to focus on the retention of existing customers and recruitment of new customers who have strong profit potential. As long as a bank has the appropriate cost and fee structure in place then a larger customer base delivers better business returns.

Attracting new customers

To gain new customers banks must motivate them to leave their existing relationship. This drive to change ultimately comes from two sources: the existing bank itself, usually the result of consistent poor service or a change in the customer's perception of the loss of value due to an increase in fees; or an external source such as another bank or non-traditional organisation offering better value for money.

The rise of mortgage brokers shows that mainstream banks were not able to react appropriately to customer demands. Since their arrival in the 1980s, brokers have managed to grow their market share so that by 2004, brokers wrote 35 per cent of all residential mortgages.[5] Though one

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thing banks do count on is that the majority of customers recognise that changing banks has an inherent cost and are reluctant to invest the time and effort to change. This strategy is supported by the fact that the Australia New Zealand Bank (ANZ) is the only major bank that has reduced the problems of switching banks by providing automated forms to notify the relevant parties.

Locating new customers

Therefore, in Australia there is a pool of very sceptical customers who are becoming more demanding and less loyal, who have embraced technology thereby using the banks' own tools to build barriers to prevent the establishment of a proactive banking relationship. This leaves the banks, who are faced with rising costs of income and falling interest margins, competing with each other for what is a limited pool of profitable customers. Yet the banks fail to recognise that, sitting on their doorsteps, there is a much neglected group of potential and/or existing customers — their shareholders.

While the Australian population is growing by just over 1 per cent the number of Australian investors who directly held shares in the banks and credit unions covered by this report increased by 10 per cent between 2002 and 2004 (1,653 million to 1,817 million.)[7] With just over 17 million bank customers this means around 10 per cent of customers own shares in banks.[8]

SHAREHOLDERS

Shareholders must be viewed for what they are: sources of capital as well as sources of profit. The fact that they are already shareholders has two inherent advantages: they have already made a favourable decision about the potential of the bank, and management can easily ascertain who they are. For unlike the USA, Canada and Europe, Australian shareholder registers are matters of public record. While institutions have a tendency to shield their identity behind nominee names and/or third parties, retail shareholders in this author's experience rarely do so.

The irony is that bank management teams have become almost obsessed about delivering value to shareholders, yet they have failed to do anything to improve their loyalty. Most corporate managers can easily quantify the cost of investors by adding dividends, cost of maintaining the register, cost of annual reports and other investor activities. Yet there is no sign in any of the research this author has conducted that shows the banks measure the amount of value that flows *from* shareholders *to* the bank.

Shareholder profiles

The Australian Stock Exchange 2003 Share Ownership Study notes that in the key savings group — 40–65-year-olds — over 46 per cent own shares directly in companies. The survey also shows that as income rises the percentage of people who invest directly increases to the extent that in 2004, 60 per cent of those with an income of more than A$100,000 invest directly. The survey notes that direct share ownership is still more evident among the higher educated and higher income earners.

If this is combined with an earlier comment that an average size of a share portfolio of those surveyed is A$40,800 there can be little doubt that shareholders have many of the characteristics of what banks would call 'profitable' customers. Additionally, research by *The Australian Financial Review* indicates that since 1983 the proportion of Australians in the prime savings years of their life — those aged 40–65 years — has increased from 33 per cent to 46 per cent.[9]

Supporting this contention is the aging of the Australian population and the

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introduction of compulsory superannuation. This means many investors are looking for companies providing dependable dividend policies as a part of their retirement income. These types of investors are interested in stability and dependability and are more inclined to invest for the long term ignoring the day-to-day fluctuations that are the hallmarks of day traders. Moreover, unlike institutional investors whose investment decisions are driven by a host of other factors, retail investors have a longer investment horizon.

In the 2003–2004 financial year the National Australia Bank (NAB) increased the number of shareholders by 18 per cent at a time when there have been many management and performance issues in the press. It would be appropriate to speculate that the steep rise in the number of retail shareholders is a result of institutional investors selling down into the retail market.

SHAREHOLDER PRIVILEGE/ LOYALTY PACKAGES

All bank management teams will say that they want loyal investors but none of the banks surveyed for this report have done more than pay basic lip-service to building a loyal retail investor base. Consider the following: only five of the banks surveyed (Westpac, ANZ, NAB, Bank of Queensland, Bendigo Bank) have instituted what they call shareholder loyalty or privilege packages. The problem is compounded by the fact that the privileges do not change for either the number of shares held, or the longevity of the shareholding. So loyalty is a word rather than an actual concept.

Cost of entry

Typically, the shareholder benefit is only available to shareholders who hold a minimum number of shares. The ANZ sets the limit at 300 shares while for the rest of banks the level is 500 shares. Doing the calculations, this means the amount shareholders need to 'spend' to access these benefits ranges from just under A$5,000 for Bendigo Bank up to over A$14,800 for the NAB. The author speculates that the actual number of shares was set at a time when market capitalisation was much lower and has not moved to reflect the increased investment shareholders may have to make.

When the Commonwealth Bank (CBA) was questioned about why it did not offer a range of incentives, its comment was that with a shareholder base of over 700,000 it was not economically feasible to develop such a package of services. Yet if it adopted the same benchmark of 500 shares, a shareholder will have outlayed over A$15,500 to access these benefits. In the general scheme of things this would appear a relatively small amount of money but if banks considered that the percentage of direct investors who now hold more than seven companies in their portfolio of companies has risen from 9 per cent in 1998 to 28 per cent in 2003 they may arrive at a very different conclusion.[1] It is this narrow approach to customer profiling that restricts the banks' ability to maximise their growth. There are no indications that the banks take a 'whole of wallet' view of their shareholders.

The packages

A review of the published shareholder packages finds the benefits the banks are offering are very similar. The benefits typically range from higher interest rates on some form of deposits, to discounts on insurance products, to a reduction in some loan fees. All of the offers are couched in typical banking language and there is no attempt to develop a profile that quantifies the potential savings. In more than one

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case a shareholder actively has to search the company's website to locate the details of the benefits package.

Additionally, the banks do nothing to encourage the shareholder to take up the privileges. All of the banks state in their marketing brochures that it is up to the shareholder to activate the benefits. There is no proactivity from any of the banks to contact shareholders to encourage them to take up the offer and/or to transfer their accounts.

None of the five investor relations/ corporate affairs departments could or would detail the percentage of their shareholders that had taken up the shareholder packages. They all commented that it was not possible to measure the response and they did not keep those statistics. Westpac takes it one step further, stating in its shareholder benefits brochure that 'there is no direct link between their shareholder database and the Westpac customer or product databases'.

During the research, none of the banks attempted to identify retail shareholders who did or did not have their principal banking relationship with them. This is the ultimate in non-relationship management. Here is a known group of people who for the best part have decided to invest their discretionary funds in shares in a bank and the management of the bank has shown little interest in cultivating a relationship. Yet the purchase of shares signals that the investor believes that this bank offers superior returns when all other similar investments are considered.

COMMUNICATING WITH SHAREHOLDERS

Despite the many thousands of dollars each of the companies spend on their annual reports (millions of dollars in the case of the larger banks) there is little sign that the banks recognise that the annual report offers them an opportunity to convert shareholders into customers. The annual reports, whether concise or complete, focus on the traditional messages of operating revenues, profits and increases in shareholder value. Most of them contain general marketing messages that centre either on changes in service standards (Westpac) or trumpet their success (St George Bank). Only one bank (Bendigo Bank) attempts to use its annual report to discuss the range of products it offers.

MAXIMISING REVENUES

Taken to its logical conclusion, if shareholders are serious about their investment they should back their judgment by transferring their accounts to that bank. Undoubtedly part of the problem lies with shareholders not extrapolating fully their investment decision. Namely, that by transferring their accounts to the bank in which they have purchased shares they are contributing directly to ensuring the bank's continued growth; this can translate to increased profits, which can translate to increased dividends. Further, the payment of dividends actually offsets the fees the customer pays, as the dividends are derived in part from the profits earned from customer fees paid.

Similarly, if banks thought it through they should want to maximise the retention of dividends paid out. By not working to have all of their shareholders' accounts with them they are undermining their own profit results, for the dividend income that is transferred to other financial institutions becomes deposit income that contributes to the success of their competitors. In other words, it is like buying a BMW but investing in the Ford Motor Company.

WHERE TO FROM HERE?

What can be seen is that although

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Australian banks prefer to have loyal customers and loyal shareholders they have not put the necessary effort into translating these thoughts into action. Banks cannot achieve investor loyalty simply by delivering more and more value to all of their investors. With a limited pool of customers, a rising cost of income and reduced interest margins, banks who want to maintain historical levels of returns need to view their investors creatively. Considering the great diversity of shareholders' investment strategies, a bank will do better by segmenting its investors. By dividing shareholders into smaller segments based on similar characteristics, banks can build suitable relationship packages.

The future of retail banking lies in the effectiveness of the banks' ability to fulfil their customers' financial wants and needs. One strategy to hedge the continuous customer movement between products, services and institutions is to change the focus from the products and services and concentrate on achieving an end goal with the banking customer.

Traditionally, creating shareholder value has been seen as a flow from a company to its shareholder, perhaps it is now time to think about the value that flows from the investor to the company.

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