

DEPARTMENT OF CO-OPERATIVE SOCIETIES

U.WINDT:SMc
Ext.8120
Ref:P8805-18

SUBMISSION TO THE MINISTER FOR BUSINESS AND CONSUMER AFFAIRS

RE: MACQUARIE BANK REPORT : STATE BUILDING SOCIETY

Background

The Board of the State Building Society commissioned the Macquarie Bank to address a brief exploring future options for the Society. The Report was considered by the SBS Board on May 5, 1988.

DATE OF SBS
BOARD ROOM →
COUP - SBNSW
TOOK OVER

SUMMARY : MACQUARIE BANK REPORT

Key Issues Canvassed:

1. Future of the Industry

- . Trend is towards fewer, larger institutions.
- . The number of building societies is declining.
- . There is a loss of market share to the banks (this view is contested by the SBS' General Manager).
- . All financial institutions are tending to provide a broad range of products. There is not much scope for a niche strategy.

2. Independence

- . The SBS is not genuinely independent, although the State Bank has been a benign shareholder to date.
- . The SBS can remain independent (in its current form) for the short and medium term (3-5 years).
- . If the State Bank sold its holding SBS would not need to raise further funds to become independent.
- . The long term requires absorbing other retail banking business.
- . The key to independence is whether
 - (a) it can develop a competitive and sustainable business,
 - and
 - (b) it can attract non-controlling equity by offering adequate return.

To achieve this SBS would need to improve its performance.

DONE?
1987/88
15/7/88
ME
16-6-88
JD

- . The required rate of return would be between 15%-19% post-tax (a point vigorously contested by SBS' General Manager - this rate of return is equivalent to 21%-37% pre-tax and considered by SBS as unrealistically high).
- . Public depositors see SBS as secure and would continue to do so even if the association with the State Bank ceased. Attracting funds is not likely to be a problem even if SBS was independent.

3. Merger

- . Macquarie think it highly likely that SBS will have to merge with some entity because independence can only be maintained by growth. Organic growth is very difficult therefore growth by merger is more practical.
- . The State Bank should be in a position to offer the best merger terms.
- . There is the option of the State Government to own the SBS directly but is rejected.
- . There is not much sense in other options such as SBS being a subsidiary, department or division of the Bank.
- . Maximum rationalisation will come from a merger with someone who has a similar style and culture otherwise the merger process is very difficult. Independence may be sacrificed however. St. George is given as an example. (It is noted that the Bank and SBS have different cultures, objectives of management and style of business).
- . A merger with regional NSW Societies is feasible (with perhaps less benefits but will add 'mass' to the business enabling greater prospects for independence).
- . Interstate mergers may keep the Society independent (again with perhaps fewer benefits and add 'mass' to the business).
- . The pitfalls associated with mergers should be noted, for example, envisaged benefits are hard to achieve in practice, mergers are distracting in the day to day conduct of business, mergers usually trigger competitive responses aimed at eliminating the advantages of the merger etc.

4. Corporate Structure

- . Options are for a Building Society or a Savings Bank (probably not a trading bank).
- . Conversion to a Bank is only worthwhile if it moves away from its home lender base.

- . A change from its specialist home lending business would take time. Therefore the benefits of conversion to a bank, given the costs associated with conversion, could only be realised in the medium to long term.
- . Conversely, if SBS was restricted to deposit taking and home lending then there is no clear advantage in converting to a bank.

(Note: The Terms of Reference did specify examination of corporate structure in the light of SBS "fundamental mission as a specialist home lender").

5. Capital Requirements and Sources

- . The SBS has been unable in the past to generate sufficient capital growth to finance its growth internally, and therefore has needed external sources of capital.
- . As a bank it would need to double its capital plus meet capital requirements to sustain real growth.
- . As an independent body SBS could seek funds from
 - Depositors and small investors
 - Corporate investors with special interests (such as housing developers, other building societies).

The Report has no quarrel with SBS' estimate that \$15-20 million can be raised.

- . As a bank it would look to the same investors, the broader public and institutional market (which is depressed in the medium term).

6. Relations between State Bank and SBS

- . Since the settlement of the State Bank dispute with the Commonwealth Bank the status quo between the State Bank and the SBS is not likely to continue. The two are now competitors in the same market, while the Bank is in a position of influence and some control.
- . The agency agreement does not make a clear contribution to growth of SBS business and will do so even less in the future.
- . The profitability of SBS would not be reduced if the agency agreement was terminated.

87/88
RESULTS
DISAPPOINTED THIS

THE SBS
MADE \$22M PROFIT.
87/88 - SONSW KNEW
THIS -

*COPY
HELD OFF FILE*

SUMMARY : SBS' GENERAL MANAGER'S RESPONSE TO MACQUARIE BANK REPORT (OVERVIEW)

The SBS response comments on the lack of substantial evidence used in the Macquarie Bank report to support its conclusions. Where factual data was used and significant difference found by SBS they provided alternative material.

The following are points of significance raised in the SBS 'overview'.

Future of the Industry

- . The Macquarie Bank report states that there has been a loss of market share to the banks. SBS contends that the non-banks have maintained market share of lending, and that it is the established banks that have lost share to the new banks (figures supplied).
- . No reference is made to gain in market share for building societies in consumer credit and commercial property.

Independence

- . The Report claims that a post-tax yield of 15%-19% will be required to attract investors.

This represents a pre-tax dividend of between 21%-37% (in absence of imputation) which is unrealistic.
- . The Report comparisons between SBS and its competitors ignores key facts and causal factors:-
 - Profits in 1986/87 affected by interest rate regulation, Federal Government subsidy to savings banks, costs associated with the agency agreement.
 - Substantial investment in new skills : Marketing, Treasury, Commercial Property, Consumer Finance, Insurance, Retirement and financial advice. These are now beginning to pay off.
 - An extensive DP system handling more outlets than St. George, Advance and NMRB.
- . The deposit/branch ratio is better than most competitors (SBS is 4th).
- . The rates of staff per \$M1 is better than most competitors (SBS is 3rd).
- . There is a statement in the Report that conversion to a bank will attract lower cost of funds from a wider variety of sources.

These sources are already available to SBS.

Merger

- . SBS has "a near perfect fit" with regional building societies in the Hunter and Illawarra. They have
 - complementary branch networks
 - similar corporate structures
 - complementary markets.

The result would provide strong competition to St. George and the Savings banks.

NOT
WHAT
HAPPENED *

Corporate Structure

- . There are few restrictions left on building societies in comparison to savings banks. Those that exist are likely to be lifted in an environment of deregulation.
- . Conversion to a savings bank invites costs with no perceivable benefits. (This is not inconsistent with the thrust of the Macquarie Bank's Report).
- . In certain instances building societies that converted to banks (NSW Building Society, National Mutual (Vic), Civic (ACT), United Perth (WA) and Metropolitan (Qld)) did so at a time when their legislation was limiting or still is, in their State.

This is no longer the case in N.S.W.

Relationship between State Bank and SBS

- . Profitability of the Agency has been consistently declining since 1983/84 (figures supplied).

Further Considerations


- . The Macquarie Bank report is not accompanied by detailed analysis of either the State Bank's contribution to the profitability or otherwise of the SBS. Neither is there a detailed analysis as to why it is not possible for SBS to remain independent.
- . If in fact it is in the best interest of members/shareholders for a merger to take place two aspects are possible.
 - . That 'tenders' be sought giving all interested parties an opportunity to put a proposal to the shareholders.
 - . That SBS maintain its independence in the short term and solicit further merger partners. Any merger with regional building societies would only arise from this approach.

Recommended

The above summary of the Macquarie Bank's Report, and the former General Manager's (Mr. Cleary's) comments thereon (copies attached) are referred for the Minister's information.

 2/6/88

The Minister


REGISTRAR

17-5-88