

## Glenn Stevens: Bendigo Bank's 150th anniversary – historical look at banking in Australia

Remarks by Mr Glenn Stevens, Governor of the Reserve Bank of Australia, to Commemorate the 150th Anniversary of Bendigo Bank, at an Invitation-only Dinner, Bendigo, 9 July 2008.

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The Premier, the Hon. John Brumby; The Right Reverend Bishop Ron Stone; the Mayor of the City of Greater Bendigo, David Jones; the Chief Executive Officer of the City of Greater Bendigo, Craig Niemann; the Chairman of Bendigo and Adelaide Bank, Robert Johanson; the Managing Director of Bendigo and Adelaide Bank, Rob Hunt; Local Members of Parliament; distinguished guests; ladies and gentlemen.

It is a pleasure to be here in Bendigo this evening as you celebrate the sesquicentenary of Bendigo Bank. Your city is resplendent for the occasion, and one cannot help but get a sense of the history as one moves around here.

And what a history it has been – from sheep paddocks, to gold rush, to prosperous modern city. You have much to show for the past century and a half.

Like so many of our fine institutions, the beginnings of Bendigo Bank were actually rather humble. In the early days following the discovery of gold in 1851, the population of this town grew rapidly. People came in search of wealth and, as always in such a search, some had success and some didn't. The population – one in fifty Australians lived here at one stage – was rather transient. Certainly many of them were far from well housed: thousands lived in tents.

The prominent citizens who had decided to make Bendigo their home permanently wanted to encourage a more stable, home owning society. The building society movement that had earlier taken root in Britain provided a model of how to go about it. And so, on 9 July 1858, the Bendigo Land and Building Society was established, with 150 or so individuals subscribing 5 pounds each in capital.

This society, eventually re constituted as a permanent building society became, in combination with some other entities, the nucleus of the entity whose anniversary we celebrate today. It grew with its community and by merger and acquisition with other building societies and financial institutions, both locally and further afield. In 1995, then Australia's oldest and Victoria's largest building society, it took a banking licence and developed further into the institution that we know today. Following the merger with Adelaide Bank, the new entity has assets of around \$50 billion, and is Australia's 11th largest bank.<sup>1</sup> Though small in market share, its branch presence is considerably larger.

If we were to compile a list of financial institutions of the second half of the 19th century, we would find that few of the names would be familiar ones. Not many entities of that time are still in existence today. Our major banks, of course, have a long history, in some cases dating back to the early convict era. But a great many financial institutions of the 19th century, particularly Victorian building societies, succumbed to one or other of the busts that occurred in the 1890s, the 1930s and the 1990s.

The 1890s episode was a particularly severe depression in Victoria, with a collapse in land values and widespread closures of financial institutions. Nearly half the building societies

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<sup>1</sup> Ranking based on banks' resident assets in Australia.

closed. This, as always, followed a period of extreme euphoria. Consider the way the historian Michael Cannon describes the general scene in Melbourne in the 1880s:

The land mania of the 1880s took two main forms. The first was based on a plethora of building societies, whose optimistic officials believed that every family in the colony could simultaneously build their own house, keep up the payments through good times and bad, and support an army of investors who were being paid high rates of interest for the use of their money. The second form of mania was the deeply-held belief that it was impossible to lose money by “investing” in land – a belief which persists to the present day.<sup>2</sup>

Those words, penned in 1966 about an event a century ago, carry a more than faint echo of more recent times in other parts of the world. If we may paraphrase Cannon, too many of the world’s major financial intermediaries thought that loans of dubious quality, originated by salespeople they knew little about, to borrowers whose credit standing, to the extent it was known, was very poor, could be sold in ever increasing quantities to investors looking for AAA security. One day the music stopped, as it always does, and they were left standing.

The 1890s were tough for the city of Bendigo, as for most of Victoria. A number of banks in the city closed their doors. But its main building society remained sound. “The Bendigo” had not ventured as far into Melbourne real estate as others, nor was it as highly leveraged. There are some lessons there.

Moreover, the fact that “The Bendigo” has endured so long being based in a town “born of gold”, as Tim Hewat put it in his history,<sup>3</sup> is perhaps all the more remarkable. Mining towns have their ups and downs with the inevitable cycles of discovery and depletion of ore bodies, booms and busts in commodity prices and all the associated exuberance, risk taking and inevitable subsequent disappointment for some, that goes with them. Bendigo in the gold rush days was no different.

For a locally based financial institution to ride through such cycles, without itself being too swept up in events, something must have been working well. It is surely not chance – 150 years would be a rather long lucky streak. More likely, this success is remarkable testimony to generations of managers who had a good assessment of risk, plenty of common sense, a strong attachment to their core business and an ability to resist the temptation of exotic new opportunities.

It sounds simple. Yet the managements and Boards of some of the world’s largest and most sophisticated financial institutions did not meet that standard during the past decade, and the fallout is now upon them (and the rest of the world). Much shareholder wealth has been destroyed and reputations of some major institutions damaged.

The result has been one of the most acute withdrawals in confidence between major institutions in living memory. Inter-bank borrowing rates at term shot up, as global banks, suddenly facing pressure on their own liquidity, became more cautious about extending it to others. Because financial markets are globally integrated, these pressures were quickly transmitted across national borders. The strains on liquidity have extended, in more muted fashion, even to parts of the world where local credit quality is much higher. Australia has suffered less than the United States, Europe or the United Kingdom, but nonetheless term funding spreads increased and remain today higher than they were before the onset of the sub-prime crisis last August.

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<sup>2</sup> Cannon, M.(1966), *The Land Boomers*, Melbourne University Press, Melbourne, p. 12.

<sup>3</sup> Hewat, T. (1992), *Banking on the Bendigo*, Wrightbooks Pty Ltd, Brighton, p. 1.

Recent developments exposed the risks inherent in a business model involving heavy reliance on wholesale, short-term funding and securitisation of loans. For some institutions, events unfolded in devastating fashion. We saw a run on a significant British bank for the first time since the gold rush days in Bendigo.

On the other hand, during this period, the virtues of a well run, straightforward business model, reliable retail funding, strong knowledge of the local market, and a suite of attractive retail banking services came once again to the fore. Soundly run institutions have seen a rise in their market positioning relative to more risky ones.

Soundness, however, is only one part of the equation. Of course we need the financial system to be a safe repository for the savings of the population. But to play its full role in the economy, the financial sector needs also to mobilise those savings, putting them in the hands of investors who are in a position to make effective use of them. Banks are in the business of risk management, not complete risk avoidance. Their job is to offer a secure savings vehicle on the liability side of the balance sheet, but to take a measured degree of credit, maturity and liquidity risk – very carefully managed! – to provide finance for sound investment propositions. Those propositions range from housing, to small business, to large scale investment projects such as the ones that are happening apace at present with the commodity price boom. With capital markets struggling at present, this role is even more important than it normally is. In addition, the transaction services that banks and other authorised deposit-taking institutions offer their customers are key to facilitating the huge volume of transactions which occur every day in the modern economy.

Historians point out that this function of the financial system broadly defined – the efficient mobilisation of financial capital – is critical for economic growth. As the industrialised economy took shape, markets for capital grew alongside. Had it been otherwise, brilliant technological innovations would have remained in the laboratory, entrepreneurship would have been stifled, growth would have been slower and living standards lower. Debt and equity markets, together with banks and other financial intermediaries, have been, and remain, key parts of the financial infrastructure.

The history of Bendigo provides a good example of this general principle. In the early years, prospectors sought alluvial gold, which was found in or around streams and for which the requisite capital equipment was a pan and a shovel. As time passed and prospectors increasingly turned their attention to quartz-gold deposits, in some places deep underground, more physical capital was required. Steam- and air-driven equipment made men working deep underground productive enough that profit could be earned even when a great deal of rock had to be lifted to the surface and processed to find an ounce of gold. The formation of company structures, and the establishment of a local stock exchange in the 1860s, facilitated the provision of finance for all this activity.

Now, of course, this was not without risk. Moreover, one could hardly claim that the exchange was not given to occasional bouts of “irrational exuberance”. Geoffrey Blainey’s account of October 1871, with trading continuing on the streets into the early hours of the morning, with even the destitute seen “pencilling [their] own share transactions”, gives the flavour.<sup>4</sup> Capital markets are prone to bouts of euphoria, which is why it is best if banks and other deposit-takers keep a polite distance from the riskier end of the spectrum, and avoid lending against the more speculative assets. Nonetheless, for all their occasional dislocations, the development of equity and debt markets has been important in the advance of the modern economy. Today, the Bendigo Stock Exchange, like Bendigo Bank, continues, even if in slightly less colourful fashion, providing an equity market for small- and medium-sized firms.

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<sup>4</sup> Blainey, G. (1963), *The Rush That Never Ended: A History of Australian Mining*, Melbourne University Press, Melbourne, p. 75.

In the period ahead, at the global level, it will obviously be critical to restore the proper functioning both of capital markets and of major international financial institutions. Losses need to be recognised, capital structures repaired where necessary, risk management processes re thought and managerial incentives more carefully structured. That process is under way, though it may have some way to go yet. The main Australian institutions are generally well placed, in my judgement, to prosper in this environment, if they continue to manage their businesses well.

At the local and regional level, meanwhile, there is an ongoing role for the provision of financial services. Bendigo Bank's community banking model, which seems to be a very successful one to date, is an innovative response to the demands of local communities for such services. The major banks tended to scale back their regional presence, in response to the cost pressures on them after the events of the early 1990s, and the changing economics of branch banking which became apparent as financial liberalisation proceeded. This withdrawal left an opportunity, but to take it, someone had to devise a business model that could cover costs at a price which the community could accept. The Bendigo model seems to meet this test.

In short, though I do not say this as a supervisor of banks, this model seems to have worked pretty well. It shows that not only is there an important role for regional banks in the modern world, but that well run institutions can successfully fill that role. As we are constantly reminded, even in a globalised world, communities are still local in many important respects.

So in conclusion, to the shareholders and managers of Bendigo Bank, and the broader community of Bendigo: "Happy Birthday". I wish you many more. I am sure John Laker, the Chairman of APRA who is here this evening, would join me in exhorting you to continue your wise and prudent management so that the City of Bendigo, its bank and its people will prosper for another 150 years.