Address to the Melbourne Business School

Mike Smith
Chief Executive Officer, ANZ

Good evening and thank you for the warm welcome.

It's a great pleasure to have the opportunity to talk to the School's students, alumni and academic staff this evening.

I have always believed that universities should be a forum for the debate of ideas. In this incredibly challenging time, business schools of course have a special role to play in leading that debate between industry, government and the wider community.

I thought therefore this evening I might set the scene on some of the critical issues I believe we are now facing.

I'd then like to open up the conversation and use the majority of our time to explore your views on how the economy and business will change in the aftermath of the financial crisis and economic slow down.

First, it's now very clear that over the past 18 months, many of the assumptions that we've built the foundation of our economic prosperity on over the last 15 years have been challenged and found wanting.

The result is the creation the most difficult set of economic conditions the world has faced since the 1930s and a dramatic reshaping of the global economy and business.

In global banking, to be frank, it's been a bloodbath. Since January 2008, there's been over US$1 trillion in losses, 40 bank failures and 275,000 jobs lost in financial services – most in the United States.

And whilst the turmoil was initially in the financial sector, it is now clearly being felt in the real economy throughout the world.

Many advanced economies are in recession and there is a slowdown taking place in the emerging markets.

The prospects for the world economy in 2009 are, in a word, bleak.

The world's 'advanced' economies, as a group, are likely to experience their first annual contraction in economic activity since the end of the Second World War – by the order of close to 2 per cent.

As a result, the philosophy of 'small government' is now officially finished and governments around the world are now playing a much larger and more directive role in the economy.

Economic stimulus packages put in place by government's around the world in the last year now total US$2.5 trillion.

And while there is debate about the size and targeting of the Australian Government's fiscal stimulus package, there is no question that this action is both welcome and necessary in order to minimise the depth and extent of the downturn in Australia.

At the same time, some of the world's largest banks – for example, the Royal Bank of Scotland, Lloyds Bank and Citibank – are now majority or part government-owned.

The auto industry is next in line for bailouts in the US and the queue is forming quickly behind that.

Of course in Italy, where the government always provides us with new economic perspectives, it has come to the rescue of Parmesan cheese. It has dipped into a special EU fund for the needy and bought 200,000 wheels of Parmesan and donated them to charity.

No doubt you'll all appreciate the sense of this uniquely Italian bailout when you dine in Lygon Street a little later.

In Australia, the four major Australian banks are now among just 11 AA-rated banks in the world and have not required any government capital and have not received one cent of taxpayer's money.

That's strength; however conditions are very difficult with rising bad debts and tight funding conditions.

Maintaining the AA-rating of Australian banks in this environment is going to require more capital and some very tough decisions about efficiency.

The inevitable aftermath of the recent failures in the financial system and in business is however going to be greater regulation.

The challenge here is going to be how we find a balance between free markets which are the best tool we know for fostering innovation and generating wealth, and ensuring there is a watchful eye from regulators that can help markets avoid overshooting and spinning out of control.

We only need look back at regulatory changes in the US to understand the need for balance and care in regulatory reform to ensure it does not give rise to serious consequences in the future.

For example, the Sarbanes-Oxley act and the repeal of the Glass-Steagall Act which had, since the Great Depression, forced a separation of commercial and investment banking.

In Australia it is worth reflecting that we have had the benefit of good regulation and most importantly, good regulators who have, by and large done their job.

It will be crucial to both the short- and longer-term prospects of the global economy that governments resist the pressures to over-regulate.

While governments have an important and necessary role in repairing the global economy and building a more flexible and resilient financial system, they also need to avoid the serious mistakes of the past – the mistakes which produced Japan's economic stagnation of the 90s or those which created the Great Depression.

What concerns me most right now is that as the economic slowdown deepens and unemployment rises, we are seeing some politicians and community leaders get in touch with their 'inner populist' which risks drawing governments into impulsive, uncoordinated and ultimately counter-productive responses.

The Australian Government has so far done a commendable job in resisting these pressures.

However, around the world we are seeing globalisation and free trade, which has underpinned economic growth and prosperity for 60 years, being tested with emergence of economic nationalism and protectionism.

As The Economist magazine pointed out recently, trade encourages specialisation which brings prosperity. Global capital markets, for all their recent problems, allocate money more efficiently than local ones. And economic cooperation encourages confidence and enhances security.

And although the trade links which bind countries are undoubtedly under strain, I hope that the world has learnt the lessons of the past that economic nationalism actually exacerbates economic contractions.

As the G20 leaders gather to meet in London today, it's worth noting at their last meeting in Washington in November there was agreement to "resist protectionism".

According to press reports the intent at the G20 is still to resist protectionism at today's meeting however this now needs real leadership and real action.

This needs to extend beyond protecting global trade flows to protecting and supporting global capital flows which are much larger and, as we have seen, potentially far more disruptive.

In Australia, our economy is probably weathering the current turmoil better than just about any other Western economic and financial system.

Why?

Apart from the relative strength of our financial system, economic growth in our region – Asia – led by China, is running at almost 5%. This compares to the OECD economies which are now contracting.

Over the last two decades we have watched the industrialization and urbanization of China and India.

In 10 years China will have 15 cities each with more people than live in Australia, and a further 22 cities with more than 10 million people.

This enormous growth has seen GDP grow at a compound annual growth rate of over 9 per cent for 30 years and means that Chinese growth is driving world resources demand.

Although there is clearly a slowdown occurring in China, particularly in areas such as the Pearl River Delta, I believe the Chinese Government has both the political will and the financial resources to manage its impact.

To help us decide whether this is real or just a fading star, let me give you two facts and ask you a question.

Today, China represents 21 per cent of world population and over 10 per cent of world GDP.

Do you believe these proportions will remain constant?

The answer is obvious and the Australian Government is demonstrating it understands this by seeking a balanced pathway to engagement with China and Asia more generally.

This approach to engagement is clearly in the national interest and is the right approach now and for the future.

But the benefits of open markets are not just about finding markets for our natural resources, attracting foreign investment flows or Australian businesses creating opportunities in Asia.

They also involve acknowledging the role Asia can play in helping our economy and our companies grow in a cost effective way and become more internationally competitive.

We have already seen this in manufacturing.

There is no doubt in my mind that in the services sector too, productivity improvement continues to be one of the keys to a company's survival and success.

For example, many companies are looking to India as a global leader in innovation, technology and cost.

The reason? Simply, because of the Indian education system.

In India, the pool of young university graduates - those with seven years or less of work experience is around 14 million, twice that of the United States.

In a number of technology and operational areas, Indians are some of the most skilled professionals in the world. And it's not just in technology.

When the Indian economy liberalized ten years ago the growth of technology and outsourcing companies exploded. As a result there are now more than a thousand business schools in India.

The availability of a highly educated workforce with the right skills at lower overall cost is why companies are looking to India and other Asian countries to help drive innovation, cost and service, and free up resources to invest in front-line services for customers and new growth opportunities.

The fact is this century is the Asian century. Australia because of the good fortune of its geographic position is part of this but we need to embrace Asia if we wish to remain part of it.

We simply can not afford to listen to our ‘inner populist’ and step back from our engagement with Asia and the rest of the world.

In business of course, we have to acknowledge that things aren’t the way they were and the game has changed.

As President Obama put it, we are in a ‘new era of responsibility’.

For business, the new game requires greater recognition of the duties we have, not only to their shareholders and staff, but the role they play in the economy and the countries in which they operate.

Certainly, in banking, investment banking as we came to know it on Wall Street since the early 90s – with bonus pools for investment bankers worth billions of dollars, taking risk rather than managing risk and ultra-thin capital levels – is over. Finished.

I believe that banking, because it oils the wheels of commerce and of individual prosperity, has a special standing in the world.

To reflect this, bankers must approach their job with a strong sense of prudence and duty, experience of good times and bad, and the experience to understand and manage through the good times as well as difficult times.

For someone who has been in banking all my working life, I think of this as a return to normality.

That means a return to the importance of deposit taking in bank strategy; of more conservative underwriting standards; of margins that allow banks to operate in a safe and sound manner and to make money; of normal levels of credit losses; and to solid rather than stellar returns for shareholders.

This sense of responsibility also extends to the way we go about change in our businesses.

Where changes are necessary they need to be made transparently and with care to ensure the impact on staff is minimised by emphasising redeployment and retraining.

Some responses to the global financial crisis will of course be much more enduring than the measures undertaken in response to the downturn in economic activity.

What’s obvious is that the countries and companies that are on the front foot in recognising and adapting to change will have the most choice.

That is why it is so critically important we position ourselves as a nation and as business people to be able to capitalise on these opportunities - to deal with the issues that have emerged after 15 years of uninterrupted economic growth at the same time as setting out the long-term architecture for the future.

For Australia, more and more, that architecture involves Asia as our foundation.

There is no turning back from this.

We need policies which promote, not restrict trade and capital flows and promote balanced regulation rather than a financial system which is over-regulated and 'over-safe'.

This is essential to avoiding a protracted and deep economic slowdown and to creating sustainable economic growth which benefits all stakeholders.

Many thanks for listening to me this evening.