



Jason Yetton, Group Executive, Retail & Business Banking

“The innovation imperative”

Trans-Tasman Business Circle

Tuesday 31st March 2015

Sydney

Introduction

Good afternoon everyone.

I would like to acknowledge that this event is being held on the traditional land of the Gadigal people of the Eora nation and pay my respects to elders both past and present.

Ladies and gentlemen, thank you so much for joining me today.

We're just a over one month into the Chinese Lunar New Year and I thought I'd start by repeating a well-known saying, frequently attributed to the Chinese: “May you live in interesting times.”

Now some of you will know that it's not actually a Chinese saying, but rather an English expression, purporting to be a translation, of an ancient Chinese curse. The closest authentic approximation is the proverb, “it's better to live as a dog in a time of peace, than a man in times of war.”

Not being a true scholar on these matters, I don't have a view on that either way. But I do know that for most people to live in “interesting times”, is not perceived to be a good thing. “Interesting times” are fraught and uncertain. “Interesting times” are anathema to progress and reform. In short, they are considered to be negative. Pick up a newspaper, or turn on the television, and you could be forgiven for thinking we do, in fact, live in “interesting times”.

What I want to do today is outline why there's good reason to be upbeat about our future, and Australia's place in the world. The times aren't so much "interesting", as they are changing, and in many ways changing more rapidly, and more profoundly than ever before in our human history.

Nowhere is this more evident than on our own doorstep in Asia.

60 per cent of the world's entire population lives in Asia. China and India together, alone account for 37 per cent of the world's population. The combined GDP of Asian economies led by China and India is expected to exceed US GDP by 26% by 2020.

Australia is also changing – the mining investment boom is now well and truly behind us. The era of the automotive manufacturing sector is rapidly approaching its end. Every business and industry in Australia is transforming -old industries are declining, new industries are emerging, and innovation and disruptive technologies are fundamentally changing the way all industries communicate and do business with each other and their customers.

Our population is changing too and so are our needs. According to the fourth Intergenerational Report which details the economic and fiscal outlook over the next 40 years and which was released earlier this month (March 5), Australia's population is projected to grow to 39.7 million by 2055. At the same time 40,000 Australians are expected to be aged 100 or over and the life expectancy of men and women born today is forecast to rise to 95 years and 96 years respectively.

This will present us as a nation with many challenges, not least because workforce participation for Australians aged over 15 is projected to fall from 64.6% today to 62.4% by 2055. In effect, we will have to create more from less if we are to both sustain and grow the country's wealth. The so-called lucky country will have to become a smarter country, a more productive country and a more innovative country.

This is happening in the midst of the second great machine age of the modern era. The first was the Industrial Revolution driven by the steam engine. This one is being driven by the microprocessor and that small, inconspicuous-looking device we simplistically refer to as a phone, but in reality is so much more and is at the centre of everything we do, each and every day.

We are seeing break-through developments in cognitive and artificial intelligence (IBM Watson stand), driver-less cars (GOOGLE), Payments disruption through cyber currencies (e.g. BitCoin and Bitcash) and mobile payments (such as Apple payway). Apps like Siri can effortlessly convert and translate spoken language. In just a few short decades, the internet has gone from being a novel resource, to an essential service like gas, water or electricity. Anyone in this room that disagrees with that statement, should try living without it for a couple of weeks.

Digitisation offers exciting and potentially limitless applications, but brings with it some thorny issues too. Technological progress will leave many people behind – and render many jobs obsolete. This change will be difficult and unpleasant.

Our customers' needs and expectations are also changing. The use of technology has empowered customers like never before and has put them in control. Their expectations of ease, convenience, speed, personalisation, security, mobility has changed forever, not because of competitors, but because of comparators – think Google, Amazon, Uber, Apple, PayPal, Lexus, Disney, Airbnb.

Customer experience is the key to success.

Businesses must respond and adapt to the challenges posed by this change, or they will find themselves condemned by it. They must challenge entrenched thinking, take risks, dare I say it: 'think outside of the box', otherwise they will lose out to more nimble competitors in an increasingly commoditized world. Recent history is replete with examples of bigger business being outsmarted and outmaneuvered by upstarts that simply did a better job of predicting how consumer behaviour was changing and using new technologies to respond to a market need.

At Westpac we are acutely aware that consumer and community expectations of banks are also changing – we are in the new world of banking. Around the world governments and regulators are seeking to restore public confidence and credibility in the banking sector upon three key pillars – consumer protection, well-governed institutions, and a safe and reliable financial sector.

Against this backdrop, Westpac is changing. We cannot rely on our heritage, our brand reputation or our current business strength to stay ahead of the pack. Business as usual isn't good enough. We must adapt to the new world of banking.

In our Retail & Business Banking unit, we have an innate desire that Australia be a smart country, not a lucky country. It is tangible across our business. Whether it's supporting new Australians and the intellectual capital they bring to our nation, seizing the opportunity of the Asian Century, providing educational opportunities at the highest level to the country's best and brightest, backing Australian business to think outside the box, or supporting our entrepreneurs, industry, and risk takers, we feel this responsibility keenly.

Ladies and gentlemen, today I'd like to do the following:

- Give my frank assessment of the current state of the Australian economy;
- Outline the need for a clear vision, with innovation at its core, to support future economic growth;
- Articulate the opportunity for SMEs to capitalise on an innovation agenda, given the right policy settings;
- Look at how banks generally are stepping up to the innovation challenge amid a raft of regulation, a digital revolution and hungry new entrants in the financial services sector.

First, to our economy, which is characterised by a few things:

- Continued subdued consumer confidence;
- That well known enemy of business confidence – political uncertainty;

- Continuing challenges in Europe, politically, financially, and in terms of regional stability;
- Questions around the speed and sustainability of growth in Asia, and particularly China;
- Disruptive technologies threatening jobs and traditional players – not just in banking but across the board, as your cabbie, local video shop owner, retailer or media business will confirm;
- And then there's that that general uncertainty, particularly with the mining boom behind us, about where to next?

It would be easy to be glum, but in my view, you shouldn't be.

Yes, the RBA has recently had to cut rates to bolster domestic demand, but regardless of where rates go, I'm positive about the future when looked at in context.

1. We avoided the worst of the Global Financial Crisis – historically, Australia has managed economic adversity pretty well, and this last decade or so has been no exception.
2. Australia has had the highest median wealth in the world for five consecutive years.
3. The economy created almost 214,000 net new jobs in 2014 - 70 per cent of which were full-time - compared to just 61,000 net new jobs in 2013.
4. The Westpac Melbourne Institute Index of Consumer Sentiment increased by 8 per cent in February and is the first time since February last year that we have seen a majority of optimists over pessimists.

This isn't a bad starting point.

Then there's that other catch-phrase the 'end of the mining boom'.

Unquestionably, the rapid expansion of the resources sector has contributed very substantially to our economic success story over the past ten years, and it remains an incredibly important industry for the country – no one doubts that for a moment.

But while the investment activity has eased and resource prices have declined, the fact remains that our natural resources will continue to be in high demand. Looking behind some of the headlines, and considering the continued and inevitable emergence of millions more from poverty in China and India, I believe demand for Australian resources and services will remain strong over the next 10-20 years.

Let me be very clear about this: I have great confidence in Australia's future and our ability to outperform competitors, offer new products and services to customers, and lead the world in certain sectors. We have an enviable track record of innovation and discovery in this country. There is far more texture and complexity to our story of economic success than simply being blessed with abundant natural resources.

It is, I think, just a little demeaning to continually affirm that we are the 'Lucky Country'; to suggest we simply stumbled across our prosperity almost by accident. Because that is not how we arrived where we are at today and, intrinsic to our future success, is the recognition that we are a clever nation, that we are an innovative nation, that we are a pioneering nation, that we are a diverse and multicultural nation and that we shouldn't hide our light under a bushel or talk down our prospects.

The fact that we are living in a new era that includes disruptive new technologies, the aftermath of the GFC, the rise of Asia and the retirement of the baby boomers should not be seen as downside. Rather, it presents new opportunities and huge potential rewards for smart hard-working individuals and businesses provided that they are supported by good public policy and regulation. Industry has a big role to play here too in adopting more flexible approaches and having the courage to back new ideas.

For me, Australia's current challenge isn't about achieving success – we're already there – it's about sustaining it and turning our focus to those areas that will deliver the next wave of prosperity like agribusiness, education, financial services technology, and tourism.

AN INNOVATION ECONOMY

The first step in maintaining success is having a clear roadmap that balances the need for renewed growth and financial stability.

That starts with having a clear vision.

What are we aiming for? What is the rallying call for business? What is the vision for Australia that we need to get behind? What do we want to be?

I believe there is no greater opportunity for Australia than to continue to build an innovation economy – one that properly reflects our levels of education, our capacity to attract and retain human capital from around the world, and our strong financial position and ability to take measured risks within an appropriate regulatory framework.

There are a number of technical definitions as to what an innovation economy is. For me it's pretty simple: It is about getting on and doing stuff, but doing it better, smarter, cheaper, differently than it has been done before.

It is about backing things that are worth backing, and helping people and business to think outside of the box.

It is about making sure your policies and processes facilitate, rather than stifle, innovation and change.

It's been shown that nations that are innovative and have a strong financial system experience the most growth.

The 2014 Global innovation Index which measures 81 indicators of innovation ranks Australia 17th, which puts us at the bottom of the top quartile, but significantly outside the top 10 leaders' group.

Unfortunately we are still a bit of a way from matching relatively small nations like Switzerland, Singapore, Finland and Denmark, and lag behind nations like Germany, the United Kingdom and the United States.

Why?

To start with, we aren't investing as much in R&D as our global counterparts are. Australia will only spend \$9.2 billion on R&D in 2014-15, which translates to just 0.56 per cent of GDP, or an equal record low since Treasury started publishing data in the late 1970s. Compare that to around 2.8 per cent of GDP being spent on R&D in the United States and you get a sense of our room to move.

There are also a number of other factors that impact our capacity to innovate – education standards, how government policy supports R&D and innovation including through such things as grants and tax incentives, the extent of industry collaboration, and public investment in 'nation building' projects such as the NBN.

We shouldn't forget, though, that a big part of it also comes down mindset. Knowing what the vision is, believing in it and being encouraged to act upon it – a 'can do' culture, if you will.

Internally – we know innovation is everything – it's a game changer. So much so, that we've even made the decision to invest and finance potential rivals. For instance, we've taken an equity stake in Sydney-based peer-to-peer lender - SocietyOne. Peer-to-peer lenders join borrowers and investors through web-based technology – cutting out the banking intermediaries.

Our investment was believed to be the first equity stake a bank has taken in P2P anywhere in the world. We could fight and defend against these new entrants, but we know partnering will provide insight into the development of financial products and online credit worthiness algorithms that would otherwise be blind to us. We choose to embrace innovation as an opportunity rather than rely on scale and incumbency.

I want to talk a little now about the role of education in our innovation economy, and how Westpac is contributing to this.

As I said at the beginning of my remarks, we live in a time of constant and inevitable change. Our workforce too, is changing, and the skills that are equipping people to succeed today, will be vastly different from the skills of the workers of tomorrow.

Bruno Lanvin, Executive Director of Insead summed this up neatly when he said that "...in an environment of ongoing disruptive technologies and economic structural change, we are preparing graduates for jobs that have not even been defined today".

Australia must also take proactive steps to position itself to take advantage of the enormous opportunities in the education sector that are presented by the emerging middle class in countries such as India and China. And we need to do it quicker.

Australia's educational sector has the potential to be leading our engagement with the emerging middle class of the Asia Pacific and we must be doing all we can as a nation and as leaders in business to keep attracting young talent to our shores.

This is Australia's largest non-export industry and the third largest after iron ore and coal, generating about \$15 billion in revenues each year. The opportunities presented by the emerging demand for education and reskilling in the Asia Pacific, including through online technologies, are immense.

Take India for example, the world's largest democracy, current population 1.24 billion. It is estimated that India's working age population will grow by 240 million over the next 20 years. Currently, around 60-70 per cent of the Indian workforce has not completed secondary education.

The need to increase the education and skills base of the population is crucial given India's annual growth targets of around 8 per cent on average over the next five years. According to McKinsey, India will need to retrain at least 285 million working Indians with no secondary education – and 150 million of these have not even completed primary education.

China also presents huge opportunities:

- China is by far Australia's largest trading partner
- China is our largest source of immigrants
- China is our largest source of overseas students – there are 120,000 Chinese students studying in Australia right now

The free trade agreements signed last year by Australia will be transformational in boosting growth and create more jobs for Australians, particularly in agriculture and services.

Importantly for Australian business, the FTAs create a huge opportunity to expand their engagement with Asia. Fortunately for Westpac, we have been active in China for over 40 years and we are well placed to help customers take advantage of the new agreements.

By 2020 China wants half a million new international university students; and to train more than five million people through vocational education in key areas of economic demand.

The fundamentals of our education sector are extremely strong but we must respond flexibly and nimbly to the demands of this market in our region, including through online education opportunities.

Westpac is proud to be partnering with the China Australia Millennial Project to bring together 200 young innovators aged 18 to 35 years from across China and Australia to tackle challenges common to both countries, including global talent and digital disruption.

Not only does this sort of initiative form a collaborative bilateral hothouse for creative solutions to universal problems longer term, it creates relationships between participants and by extension our countries that will come into play as these future leaders grow and expand their careers.

Our focus on education and developing people-to-people links is also echoed in our Bicentennial Foundation.

The Foundation is a scholarship fund with an exclusive focus on the education and advancement of the best and brightest Australians with a one-off contribution of \$100 million to fund 100 scholarships and awards every year in perpetuity.

There are a number of categories including 'Asian exchange' which provides Australian undergraduate students with the opportunity to spend a semester studying at a leading Chinese or other Asian University, as well as 'Young Technologist' which provides financial study support for those who work at the cutting edge of technological innovation.

Unless you're an Indigenous Australian, we are all migrants to this country. The story of modern Australia is an immigration story, and immigration will continue to play a critical role in building an innovation economy that can compete globally.

Globalisation has given rise to a large pool of highly mobile populations seeking better employment and lifestyle opportunities. It's only natural that Australia with its impressive standard of living and lifestyle would rank near the top of the list, and attract the best human capital in the world.

Looking at the media much of the contemporary debate about immigration in Australia tends to be dominated by a focus on refugees. Meanwhile, the enormous economic and social contribution of Australia's skilled migration program is sometimes overlooked, despite being at the heart of many of our past successes, and the heart of our future.

The statistics tell the story. Migration from Asia and China in particular has increased significantly in the past few years. Chinese now make up the largest migration group to Australia, exceeding the UK and NZ (2013 stats).

Currently Australia welcomes 900,000 migrants each year – 100,000 of which come from China, a further 130,000 from India and South East Asia. And we expect migration flows from China will continue to increase.

At Westpac we've seen a 30 per cent uplift in new bank customers coming from China compared to prior period last year. Quite clearly, the way in which businesses respond and adapt to the commercial opportunities presented by these kind of people movements will be intrinsic to their success of the medium to long term.

So whether we are big or small business, industry associations, community groups or legislators we need to choose to act as leaders and ultimately, it is leadership that will foster a culture of innovation and confidence. Business and government both have a particular role to play.

Governments influence the number and types of people that live in Australia and their skillsets, they determine our regulatory policy, build the infrastructure and set the educational standards.

Business creates value, takes risks, innovates and pursues growth and builds a resilient, skilled and innovation driven workforce.

But our first collective job is to have the same vision and be pulling in the same direction – a smart, innovative, productive and confident Australia.

THE SME OPPORTUNITY

For me the obvious opportunity is our SMEs.

Take for example, birdsnest.com.au. With big dreams and a passion to solve the wardrobe dilemmas of women across Australia the business has developed from a small family clothing store in rural NSW to become one of Australia's largest online fashion retailers.

Jane Cay, Founder and Director has achieved wonders in the town of Cooma in rural NSW with a population of 7000. Employing about 100 local people, her business is helping to breathe new life into the town.

Jane started out packing parcels in a small back room and personally carried orders to the post office in her arms. Their first expansion was to a 400sqm space and now, with Westpac's help Birdsnest occupies a huge 2000sqm shop and warehouse to meet the growing demand. Now the post office comes to her – with a truck!

This is just one example of a number of businesses that Westpac is backing.

Because we know SMEs are the backbone of our national economy, contributing a little over half of private sector economic activity, valued at more than \$530 billion. They have the scale to help fill the gap created by the reducing economic and business activity of traditional sectors.

They account for half of all employment.

And our SME sector is thriving. The Global Entrepreneurship Monitor suggests that Australia has high rates – second only to the US among “innovation-driven economies” – of both nascent and young firms.

Further, Australia has the highest proportion of start-ups motivated by “improvement-driven opportunity”. The measure where we fall down is internationalisation.

With the right government and business support they are virtually unstoppable.

There is no doubt the current Federal Government is making an impact in attempting to reduce the burden of compliance, regulation and red tape on small business. The dedicated Red Tape repeal days are a good start with the Parliament removing nearly 1,000 pieces of legislation and regulation totalling over 7,200 pages last October alone. The fact that we have a Federal Cabinet Minister in Bruce Billson, devoted to supporting the needs of small business and making life easier for small business proprietors, is a very good development.

But there is more to be done.

The cumulative burden for SMEs includes taxation compliance - income tax, GST collection, PAYG income tax collection and payment for employees, fringe benefits tax collection and payment as well as state payroll taxes. Employment compliance includes industrial relations, superannuation and occupational health and safety obligations. This is on top of industry specific requirements which for businesses in areas like retailing, food and beverage, manufacturing or horticulture involve a range of local and state authorities who will also regulate activity.

A further streamlined approach to regulation would considerably help SMEs embrace an innovation agenda. And that includes banks looking at our own rules and requirements and ensuring they are not an impediment and further red tape on the SME sector.

Digital and online is another opportunity. About 60 per cent of SMEs say they do not have the skills to make the most of online services with a similar number having low or very low digital engagement.

Recent research from Deloitte Access Economics found that small businesses that use the web effectively are twice as likely to be growing revenue, and earn twice as much revenue per employee.

As we know, online sales have increased significantly, growing by 25 per cent from 2011 to 2012. While the rate of growth has slowed in 2014 to about 13 per cent, it is still growing at a faster rate than traditional retail.

So we need to provide forums and avenues for education and advice on technology and on-line for our SMEs. The banking sector, as well as governments and the business community as a whole have a shared responsibility to encourage and foster their spirit of innovation. At Westpac this means that if an idea is worth backing, we'll back it.

We back over 750,000 businesses so we see first-hand some of the most innovative

concepts that are transforming industries.

For example, braaap Motorcycles based in Launceston. As we approach what we think is the end of automotive manufacturing in Australia one young entrepreneur backed by Westpac has set out to transform the industry. With a dream of building a niche motorcycle brand, braaap founder Brad Smith set out to find manufacturing partners that could build the ultimate dirt and road motorcycle with him.

As a young entrepreneur with nothing to offer but a vision, Brad and his interpreter visited over 50 motorcycle manufacturing plants across China; one by one getting laughed out of their offices. Finally he found manufacturing partners that believed in his vision, believed in the brand.

His mission was to create experiences that make people feel alive. There's \$40billion spent in Australia each year on non-essential, recreational products. Motorcycling is three per cent. He didn't set out to compete against Honda or Yamaha, he competed against all the things people spend money on other than riding motorcycles: football, cricket... to create desire in people and create new motorcyclists.

Westpac backed that vision - braaap is now an award winning profitable business.

The Productivity Commission is currently looking into a solution for regulating start-ups and disruptive businesses amid suggestions regulation is causing start-ups to move offshore as we struggle to keep pace with new technology-based businesses. It will be a challenge finding the balance between stifling innovation and penalising new entrants or new models, while protecting consumers and being fair to heavily regulated incumbent industries. A healthy middle-ground that considers these sometimes competing priorities is essential.

There are also still too many small businesses for whatever reasons saying they find it hard to access funding from banks and others so they can invest in and grow their business. More problematic are start-ups, which by their very nature tend to be extremely innovative ventures and therefore risky propositions for banks.

While we don't believe there is any systemic market failure to finance for creditworthy SME borrowers, a new approach is inevitable and should be embraced. Currently, there is both limited demand, and an underdeveloped private equity and venture capital market in Australia for SMEs to obtain finance on the basis of a solid business concept.

The peer-to-peer and crowdfunding market is experiencing significant growth in other jurisdictions such as the UK and US. In 2012, \$2.7bn was raised globally from this market, with only 6 per cent raised on platforms outside Europe and the US.

More than half of global crowdfunding takes the form of donation and rewards based funding. However, there may be opportunities for equity-based and peer-to-peer lending to be increased both domestically and globally.

There are further opportunities for the industry and Government to collaborate to increase SME awareness of the financing options available to meet their business needs, improve SME expertise in applying for finance and increase the confidence of SMEs to secure finance. The European Union's Enterprise Europe Network is an example of a central portal of information to assist SMEs that could be developed in Australia to assist SMEs.

Westpac supports establishing a taskforce to examine how to develop these alternative financing options in Australia to support a strong, prosperous and innovative SME sector.

This work would include examining the role the banking sector has to play in facilitating connections between investors and SMEs and a joint approach by government and industry to assist SMEs to effectively present themselves as investable opportunities.

This is just one area where government and business can jointly support SMEs to innovate and contribute to Australia's long term prosperity.

BANKING AND INNOVATION

But it's not just SMEs who need to innovate. The banking industry's innovation challenge is about survival.

I've already briefly touched on our approach to peer-to-peer lending, but just a few short years ago it, along with the growth of virtual currencies like bitcoin and companies like apple, amazon and others being financial services players was in its infancy.

Now they are hungry competitors disrupting the established players.

For instance Amazon has created Amazon capital services that provides loans to companies that retail through Amazon based on detailed understanding of their sales through its retailing system – a smart combination financial services, digital technology and retailing.

These sorts of tie ups will be a key part of our future.

So what does our future look like?

The big change I think is that previous shifts in banking technology were largely bank driven – whereas now we are dealing with customer led digitization. Customer demand for mobile financial services and their appetite for new innovations are well ahead of the capabilities of many banks.

It is already quite clear that creating a successful bank for the digital era will require a major reworking, and in many cases reinvention of today's banking operations including the products and solutions offered to customers.

Products that cross traditional boundaries will be the norm. For instance new products targeting retirees may combine travel and accommodation bookings, retirement income, insurance, multi-currency payments and foreign exchange.

Similarly, new products for homebuyers are likely to combine real estate brokerage, real estate search, valuation, financing and insurance into a single offering. These won't be simple bundling of products, they will be collaborative undertakings between banks and non-bank players.

Alternate funding models, product and distribution changes and new partnerships, a digital revolution - all linked to innovation – and all having a profound impact on the way we run a bank.

For instance, we believe branches will continue to play an important role in the lives of our customers, but not in the traditional manner. We're rolling out 150 Bank Now branches over the next three years, which are smaller, but more efficient. And as well as changing shape, they are changing location.

It means being in new areas of population growth.

It means supporting rural and regional Australia with “regional hubs” where customers can experience a “one stop shop” of a Bank Now branch, business banking centre, specialist mobile bankers and the latest high-speed and high-definition video-conferencing helping Australians overcome the tyranny of distance.

It also means being smarter about our face to face presence in rural and regional Australia and that the age of face to face simple transactional banking is quickly coming to an end. We must and we will meet the challenge of delivering quality service levels for our rural and regional customers in a way that is sustainable, and can be relied upon, over the long term.

CONCLUSION

In conclusion, I'm confident not only about the future for banking but for the future prosperity of this country.

We have a strong, robust and responsive banking sector that is transforming to meet the needs of modern Australia.

We remain the economic envy of most of the world as we weathered the financial storms, the aftermath of which are still be mopped up globally.

We have an obligation to support the aspirations and ambitions of our SMEs and start-ups so we can lead the world in certain sectors and deliver long term benefits to our businesses and communities.

We are a smart country with innovation and enterprise embedded in our DNA.

We have a compelling narrative around our future innovation led economy, and now we need to do the heavy lifting to help us get there.

Thank you.