The rise and rise of the big banks

Concentration of ownership

Technical Brief No. 15
December 2012
ISSN 1836-9014

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Technical Brief

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Acknowledgements

The author would like to thank Richard Denniss, Serena Rogers and David Baker for their contribution to this paper and Susanna Nelson for her editing.

Summary

The Australian banking industry is the most concentrated in the world and also the most profitable. In fact the 'big four' Australian banks make up four of the eight most profitable banks in the world.

The big banks have conceded that they are not highly competitive but have argued that their market power provides benefits in the form of 'financial stability'. Yet in other contexts the big four banks argue that they are highly competitive. The following evidence shows clearly that this is not the case.

This paper examines the common ownership of the big four banks. It finds that the degree of common ownership seriously challenges the idea that the big four banks are engaged in fierce competition.

Examination of the top 20 shareholders in the banks' annual reports shows that, on average, over 53 per cent of each big bank is owned by shareholders that are among the top 20 shareholders in *all* the big banks. Moreover, ownership figures for the second tier banks, the big three regionals - Bendigo and Adelaide Bank Limited, Suncorp-Metway Limited and Bank of Queensland Limited – show they are also owned by the same organisations that own the big four.

Common ownership of the big banks raises serious concerns – in particular, there is always the potential to boost profits by acting as a monopoly. These concerns are worrying, especially in the context of allegations that when a bank attempts to introduce price competition, it is the common owners of the banks that pressure the 'culprit' to desist from such behaviour.

The big banks often counter criticism with the claim that, even if they are extraordinarily profitable, that profit goes back to ordinary Australians through the dividends banks pay to their shareholders. The truth is that more than 90 per cent of Australians do not own shares directly and, for the representative Australian who has a superannuation balance, the annual benefit will be an estimated $142. This figure is well short of the $1,460 profit per person the big four make through their retail operations alone.

The new analysis in this paper is prefaced by briefly revisiting the history of deregulation, profits and market share. Since deregulation the banks have increased their share of the financial system from around 50 per cent in the early 1980s to more than 90 per cent at present. Although banks have taken market share from the non-bank financial institutions (e.g. credit unions, building societies, and money market corporations), so too have the big four banks taken market share from the smaller banks. The big four banks have largely seen off the competition pitted against them to date and have thrived in the period since the Hawke Government deregulated the financial sector.

Despite the dominance of the big four banks, a comparison of home loan interest rates reveals that non-bank lenders do compete on price, with the potential for home buyers to save more than the cost of the carbon tax each week if they shop around.

Using home loans as an example, this paper found that the cheapest of the big four banks was a good deal more expensive than many individual mutual banks, credit unions and building societies and was more expensive than the average of those institutions by 40 basis points. If the present interest rate differential were to persist over time then the average mutual bank, credit union and building society customer

would save $7,163.76 over the life of the loan for every $100,000 they borrowed. That is the equivalent of $23.87 per month.

When bankers talk about competition it is likely they have in mind the day-to-day struggle they have for market share with their rivals. For example the big four banks spend huge amounts on advertising and no doubt much more on designing new products and processes. But they largely avoid competition on price – the thing that really matters to consumers. Indeed price competition is avoided through such devices as making financial products look very complex so that consumers find it difficult to compare prices between sellers. Another tactic is to promote different 'brands' despite being owned by the same parent company, in part to attract customers who 'do not want to bank with a major bank'.

The four big banks are looming larger and larger in the Australian economy, to the extent that 2.3 cents in every dollar spent in Australia becomes their pre-tax profit, compared with 0.7 cents in 1986. This paper examines the lack of 'effective competition' in the Australian banking sector and the consequences of that. In particular it concludes that those who are concerned about the cost of living should focus on the potential to make significant savings on the very profitable financial products sold by the big four.

Introduction

In an interview on ABC radio David Murray, the former CEO of the Commonwealth Bank and previously chair of the Future Fund, referred to the big banks as 'monsters'. In his words:

> *banks fund most of the assets in the economy - whether it's businesses, governments themselves, homes or projects, whatever else. And because they do that, banks in aggregate are themselves monsters … They have monstrous balance sheets and therefore they make a lot of profit.*[1]

Whether big banks are monsters or not, the current CEOs of the big four banks insist that there is sufficient competition between them to prevent them exploiting their market power and making genuine monopoly profits. The chief executive of the Australian Bankers Association (ABA), Steven Münchenberg, has referred to the banks as being 'fiercely competitive'.[2] However, the bankers like to have it both ways. Earlier Mr Münchenberg warned against the dangers of 'too much competition', while maintaining that the banks make just 'normal returns', not 'super profits'.[3] Münchenberg suggests that there is 'effective competition'. The banks have tried to suggest that there is a trade-off between the stability of the banking system and the degree of competition in the industry. Münchenberg warned that:

> *We need to be careful that the balance is not tipped too far towards unsafe competition.*[4]

Of course, Münchenberg does not define 'unsafe competition' but it leaves open the possibility that 'fierce' competition is 'unsafe'. But the appeal for stability can be self-serving. The management of every large company can be expected to seek a stable environment where business is profitable and largely insulated from genuine competition. Genuine competition implies instability in the sense that the ability of incumbents to make a profit is constantly subject to challenge. Nevertheless it is interesting to see the banks admitting that competition is not as strong as it could be. The admission, of course, implies that downward competitive pressure on banks' profits is relatively absent.

As it happens, the Australian banking industry looks very different to disinterested observers such as the International Monetary Fund (IMF). According to the IMF the Australian big four banks are the most highly concentrated in the world[5] as is shown in Figure 1. The graph in Figure 1 shows the concentration in the banking industry as measured by the share of banking business controlled by the biggest four banks in each country. The country with the lowest share accounted for by their big four banks is shown in the left-most position in the graph through to the highest at the right.

[1] Murray, D (2012) 'Interview: Future fund chair and banks resist Swan rates pressure'.

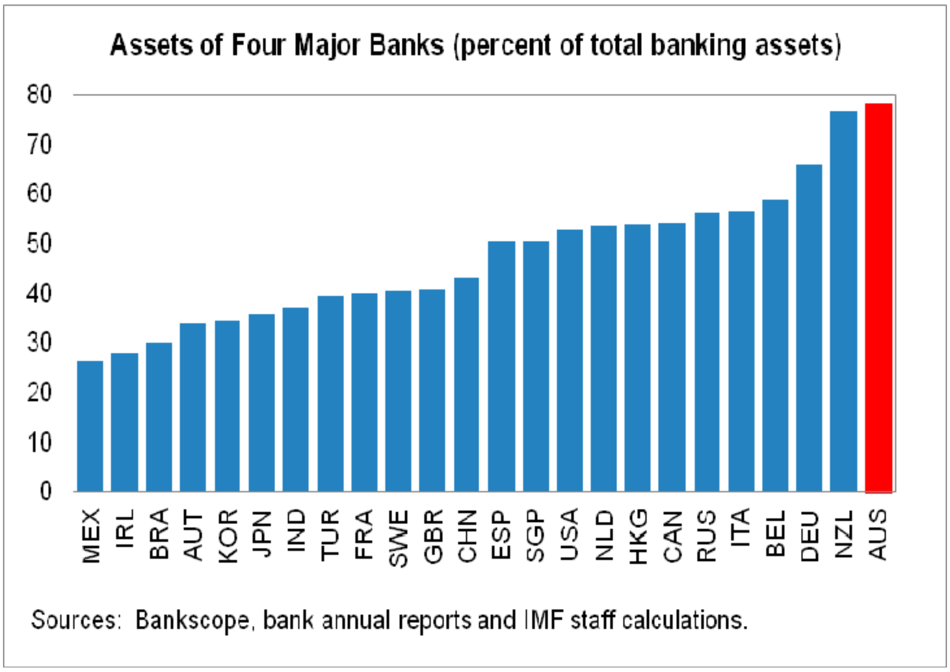
[2] Australian Bankers' Association (2012) 'Beware false savings claims'.

[3] Münchenberg, S (2011) 'Balancing bank stability and competition'.; It is important to note that the ABA does not speak on behalf of all the banks.

[4] Münchenberg, S (2011).

[5] IMF (2012) 'Australia: Financial system stability report'.

Figure 1: Bank concentration across various countries; Share of top four banks (%)



The graph in Figure 1 clearly shows that Australia has the most concentrated banking industry of the countries the IMF chose to compare with Australia. Interestingly, the country with the second most concentrated banking industry is New Zealand, whose big four banks are owned by Australia's big four banks. Australian banking is much more concentrated than, for example, the US and UK (referred to as GBR in Figure 1). In addition the IMF has shown that the Australian big four banks are four of the top eight most profitable banks in the world.[6]

The most profitable banks in the world were, respectively, the Bank of Nova Scotia followed by the Commonwealth Bank of Australia, then Westpac, the Royal Bank of Canada, the ANZ, US Bancorp, Svenska Handelsbanken AB and then the National Australia Bank – so Australian banks ranked second, third, fifth and eighth.

While the ABA denies there is any evidence that the banking sector lacks effective competition, The Australia Institute has previously argued[7] that the banking sector is a concentrated industry that earns much higher profits than would be expected in a genuinely competitive environment. The purpose of this paper is to provide new evidence of the lack of 'effective competition' in the Australian banking sector, including, for the first time, an analysis of the sources of concentrated ownership of the big four banks and a discussion of the likely consequences of that concentration. As shown below, there is a good deal of common ownership of the big Australian banks and that seriously challenges the idea that there are four genuinely separate big banks in Australia.

The ownership of the banks is highly significant in understanding the extent of competition between banks. According to newspaper reports, Cameron Clyne, the CEO of the National Australia Bank (NAB), was pressured to increase interest rates by some of the NAB's biggest shareholders, who wanted to see NAB mortgage

[6] IMF (2012).

[7] Richardson, D (2010). 'A Licence to Print Money: Bank profits in Australia'.

interest rates rise in line with the other banks.[8] In May 2012 it was alleged that 'some of Clyne's biggest shareholders have leaned on him to raise rates' to effectively undermine the NAB's strategy when it

> *sacrificed revenue but grew market share in its home loan book and deposits and set itself apart from the three other majors at a time when cynicism about the banks was at record highs.*[9]

Earlier the NAB claimed in its marketing that it had tried to 'break up' from the other big banks and set its mortgage rates below the others. The NAB said in its press release that 'we broke up with the other banks'[10] in order to offer lower interest rates to customers. It is therefore a very serious allegation by the *Australian Financial Review* that some owners of the listed banks are in position to reverse the NAB's competitive strategy.

Before specifically examining the concentration of ownership in the banking industry and the pattern of bank ownership, it is necessary to examine the context of the longer-term trends that have dominated the Australian finance and banking industry.

The rise and rise of the big banks' market dominance

An earlier Australia Institute publication*, A licence to print money,*[11] revealed that the big four banks have thrived in the period since the Hawke Government deregulated the financial sector, largely seeing off the competition pitted against them to date. Despite the faith of successive governments in the capacity of new market competitors to prevail over the big banks, the impact of these new rivals has never equalled expectations. The results, following all this 'competition', are given in Figure 2, which shows the market share in loans and advances across all financial institutions in Australia at selected dates. The top line traces the shares for banks and the bottom line shows those shares for non-bank financial intermediaries (NBFIs), which include building societies and credit unions as well as finance companies, mortgage originators and a host of other financial institutions.

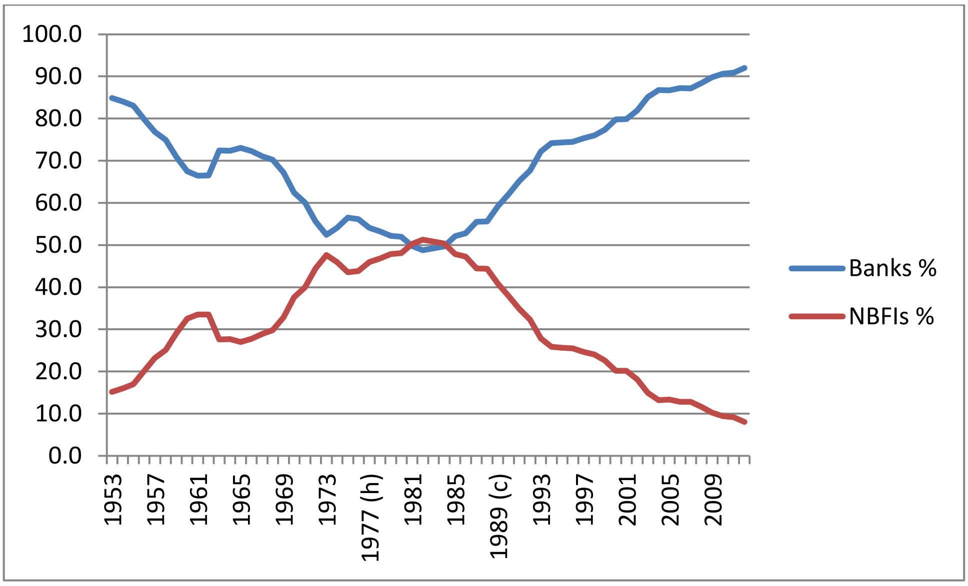
[8] Kehoe, J and Chessell, J (2012) 'Investors pressured NAB chief on rates'.

[9] Smith, M (2012) 'NAB: so much for the "break-up", due diligence'.

[10] National Australia Bank (2011) 'The break upside'.

[11] Richardson, D (2010).

Figure 2: Bank and non-bank lending shares (%)



Source: RBA Statistical tables at http://www.rba.gov.au/statistics/tables/index.html

Figure 2 shows that, soon after World War II, banks occupied a dominant position in the credit market, holding 83 per cent of all loans and advances. By 1980 the banks' share of the market had shrunk to 50 per cent. Significantly, this period of decline was dominated not by faith in competition but by regulation, which effectively constrained the behaviour of the banks over that time.

The deregulation phase began with the commissioning of the Campbell Inquiry, which released its findings in 1981, but most of the deregulation initiatives were introduced from 1983 onwards under the Hawke Government. After this deregulation phase commenced in the 1980s, the banks' share again began to rise steadily so that by 2010 they accounted for over 90 per cent of lending. Unregulated, the banks started the post-war period in a dominant position – six decades later they were again in a dominant position with much lighter regulation than when they began.

Although big and smaller banks as a whole have been eating into the market share of the non-bank financial institutions (e.g. building societies and credit unions), the big four banks have simultaneously been increasing their share of the bank market. This trend is made clear in Table 1, which shows the big four banks' share of total lending as well as housing loans. Home loans are included because of their importance in current debates.

Table1: Big four banks: share of bank lending aggregates

Date	All lending %	Home loans %
August 1991	67.2	77.6
August 1996	64.3	67.4
August 2001	70.5	74.6
September 2006	74.4	81.3
September 2011	82.2	87.9
March 2012	82.6	87.5

Note: figures include subsidiaries where appropriate.
Source: APRA (2012) *Statistics: Quarterly bank performance, March 2012,* 23 August, TAI calculations.

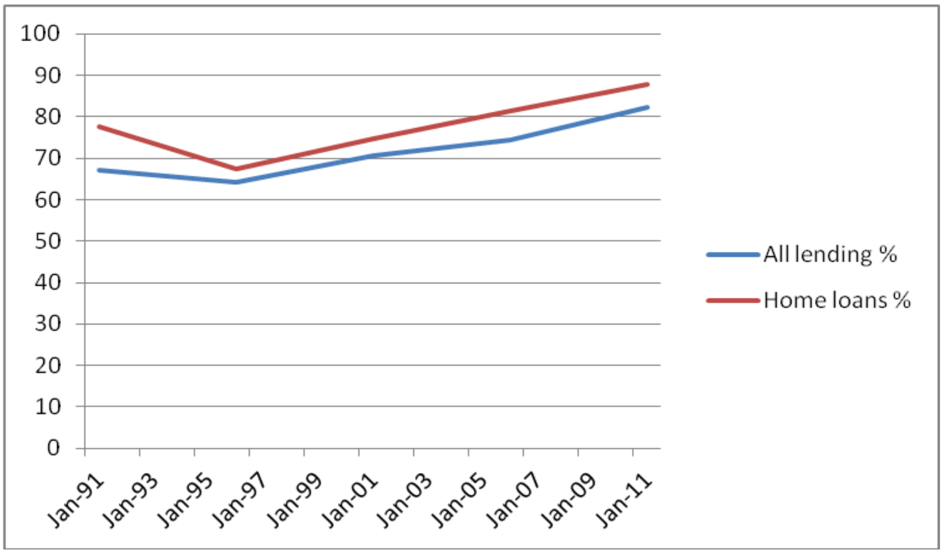
The figures in Table 1 clearly demonstrate the growing concentration of the banking industry over the past two decades, with the big four banks increasing their share of total lending from 67.2 per cent in 1991 to 82.6 per cent in March 2012. The global financial crisis occurred towards the end of this period, but the trend seems to have been firmly established since the mid-1990s and cannot therefore be considered as an effect of the global financial crisis.

Going against the trend somewhat was the dip in the share of the big four in August 1996. That dip appears to be the result of the opening up of the banking system to foreign banks and other new entrants. In August 1991 there were 45 different banks, and by August 1996 there were 52. However, in August 1991 nine of the banks were savings bank or development bank subsidiaries of other banks. For example, the Commonwealth Bank had a trading bank, savings bank and development bank. In addition there were five other banks that were subsidiaries of other banks, such as the Canberra Advance Bank, which was owned by Advance Bank Australia. So all up in 1991 there were only 31 independent banks. In 1996 there were 43 independent banks, an increase of almost a third using the same criteria – by contrast on the latest figures there are 65 independent banks, but that number falls to 45 if we remove

- four banks which have no loans and advances on their books, and
- a further 10 banks with trivial business on their books, here defined as having less than $200 million in loans and advances, and
- five former credit unions and a building society that took up the option to operate as banks.

The increased presence of foreign banks promised to reduce the market power of the big four banks, at least temporarily – but the big four banks soon resumed the trend of increasing their market shares. The trends apparent in Table 1 are represented graphically in Figure 3.

Figure 3: Big four banks: share of total bank loans and home loans



Source: APRA (2012) *Statistics: Quarterly bank performance, September 2011,* 23 February, and TAI calculations.

Figure 3 reinforces the impression, given in Table 1, of a strong trend towards domination of the lending market by the big four banks.

Bank profits

Given the increasing concentration of market power in the hands of the big four banks, we would expect to see an increase in the profitability of those banks, both as a share of total bank profits and as a share of the total economy. This section provides evidence confirming that hypothesis.

Table 2 highlights the profit share of the big four banks. Unfortunately we do not have a consistent series of bank profit figures prior to the creation of Australian Prudential Regulation Authority (APRA), but the APRA figures that cover the period 2004-05 to the present are telling.

Table 2: Big four banks' share of total bank profit

Year to June	Big four share - %
2005	75.9
2006	77.2
2007	76.1
2008	78.2
2009	90.6
2010	87.2
2011	87.5
2012	90.7

Source: APRA (2012) *Statistics: Quarterly bank performance, June 2012,* 13 November.

Concentration of financial power has enabled the big four banks to increase their profits at the expense of other banks and other financial institutions. Table 3 shows that the big four banks have also been highly successful in growing the income of the banking sector at the expense of other parts of the economy. The profits being earned on mortgage and other lending have been so large that, over the past few decades, the growth in income of banks has actually come at the expense of the growth of other industries.

Table 3: Big four banks: Profit before tax ($ million)

	1986	1989	1999	2006	2009	2011	2012
ANZ	357	773	2,162	5,214	4,380	7,883	8,311
Commonwealth Bank	396	813	2,498	5,704	5,975	9,057	9,964
National	484	1,110	4,141	7,275	6,962	6,728	6,159
Westpac	540	926	2,026	4,547	6,096	8,514	8,862
Total	1,777	3,622	10,827	22,740	23,413	32,182	33,296
Per cent GDP (%)	0.7	1.0	1.8	2.3	1.9	2.3	2.3

Sources: Company annual reports, various years.

Table 3 clearly shows that the four big banks are looming larger and larger in the Australian economy, to the extent that 2.3 cents in every dollar spent in Australia is now accounted for by the pre-tax profit of the big four banks, compared with 0.7 cents in 1986. This means that big bank profits loom 3.3 times larger in the contemporary economy than they did just 25 years ago. In money terms, profits are 19 times higher.

Kevin Davis, Professor of Finance at the University of Melbourne, argues that the best measure of profitability for the banks is their market-to-book ratio – that is, the value of the shares as traded in the market as a ratio of the underlying value of the bank assets per share. He notes that market-to-book ratios for the big four banks are all above unity, at 2.1 for Commonwealth Bank, 1.5 for Westpac Banking Corp and ANZ Banking Group, and 1.2 for NAB. Incidentally, second-tier banks, including Bendigo and Adelaide Bank, Bank of Queensland and Suncorp, all trade at a discount-to-book price.[12]

In the past Ian Macfarlane, then governor of the Reserve Bank of Australia, drew attention to the high profitability of the big Australian banks. However, the present governor, Glenn Stevens, says that the banks are not necessarily more profitable than other sectors of the economy, and demonstrated his case by referring to the top 20 companies on the Australian stock exchange. The Reserve Bank claims that the profitability of the Australian big four banks is 'similar to those of other major companies in Australia …'[13] Its measure was the return on equity of the top 20 ASX

[12] Davis, K (2012) 'Benefits of low credit growth'.

[13] Reserve Bank of Australia (2010) Senate Economics References Committee inquiry into competition within the Australian banking sector.

companies.[14] Top of the list is BHP Billiton, and there are five other miners in the top twenty: Rio Tinto, Woodside Petroleum, Newcrest Minerals, Fortescue Mining and Origin Energy. The miners all have monopoly control over their particular mineral resources. After BHP are the four banks themselves, in descending order by market value: the Commonwealth Bank, Westpac Banking, ANZ Banking Group and the NAB. Next, at number six, is Rupert Murdoch's News Corporation, which controls over 80 per cent of metropolitan newspapers in Australia. Moving further down the list, we find:

- Wesfarmers, which is Australia's largest retailer, operating Coles, Bunnings, Target, Kmart, Officeworks and many other activities, in a number of duopoly markets,
- Telstra Corp, a telecommunications operator with a near monopoly,
- Woolworths, which operates in a duopoly market with Coles,
- Westfield Group, which is unique in operating a chain of shopping centres,
- CSL, which has a virtual monopoly on blood products,
- QBE Insurance, which has a large regional presence in Queensland,
- AXA Asia Pacific, which, together with AMP, was one of the two main life offices,[15]
- Macquarie Group which is Australia's dominant investment bank; and finally
- Suncorp Group, the owner of insurance interests and the regional bank Suncorp-Metway, a minor bank nationally but with a large Queensland presence.

By and large, the top 20 companies in Australia fail to demonstrate the competitive ideal, where industries are made up of a large number of small independent firms with no market power. Rather, these companies operate in industries that are characterised by monopoly or oligopoly market structures, meaning that they are dominated by one or just a few large companies. Since the Reserve Bank made the claim about the big four banks' profitability the Australian Bankers' Association has released a fact sheet ranking the top 50 Australian companies according to their return on equity.[16] The bank with the highest rate of return was the Commonwealth. Above it were two of the mining companies mentioned above, and a mining service provider, WorleyParsons. Also featured on the list, in descending order, were

- Coca-Cola Amatil, the licensed monopoly supplier of Coco-Cola in Australia,
- Woolworths, mentioned above,
- Telstra, mentioned above,
- CSL, which controls blood products and other biopharmaceuticals, mentioned above,
- Brambles, which has a monopoly on pallets and related containers, and
- Computershare, which dominates share registries and other shareholder services.

Following those are the big four banks, but among them at number 11 is Orica, which is a market leader in the international supply of explosive and chemical products for the mining industry. The obvious result is that the only top 50 companies with higher

[14] The figures here are based on market capitalisation at 10 November 2010, around the time of the Reserve Bank's comments.

[15] AXA Asia Pacific was later taken over by the AMP.

[16] Australian Bankers' Association (2012) Fact sheet: Bank profits – frequently asked questions.

rates of return than the big four banks are companies that exercise considerable power over the markets in which they operate.

In contrast to the Reserve Bank, the Australian Treasury clearly holds the view that the banking industry earns ‘economic rents’ that are sustainable – in the sense that they are not going to disappear with competition. In its modelling of the Australian economy it uses special techniques to recognise the monopoly power of the banking industry.[17]

Oligopolistic competition among the banks

The textbook definition of an oligopoly includes a description of oligopolistic pricing strategies. An oligopoly can maximise its profits if it acts as a monopoly and sets a common price at the theoretical monopoly price.[18] A common characteristic of oligopolies is that they tend to follow a leader who becomes the price setter. The following is a useful textbook-style description of price leadership.

> ***Price leadership****. This is when one firm has a clear* ***dominant position in the market*** *and the firms with lower market shares follow the pricing changes prompted by the dominant firm. We see examples of this with the major mortgage lenders and petrol retailers where most suppliers follow the pricing strategies of leading firms. If most of the leading firms in a market are moving prices in the same direction, it can take some time for relative price differences to emerge which might cause consumers to switch their demand.*[19]

The round of interest rate increases over the course of Friday 10 to Monday 13 February 2012 provided a case study in how oligopolies set their prices. Previously the banks changed interest rates following a change in the official rate of interest announced by the Reserve Bank of Australia. The Reserve Bank was effectively the price leader. However, leading up to the Reserve Bank’s decision not to change rates on 7 February, the ANZ had announced that it was going to review rates every second Friday of each month and might move independently of the Reserve Bank. Having made such an announcement it is likely that there was significant pressure on the ANZ to ‘put its money where its mouth is’ and, to that end, the ANZ increased home mortgage rates by six basis points on Friday 10 February.[20]

The ANZ was quickly followed by Westpac, which went a bit further, increasing rates by 10 basis points later on Friday. By Monday the others had followed: the Commonwealth Bank increased its rate by 10 basis points and the NAB increased its rate by nine basis points. After a long history of changing interest rates in response to Reserve Bank moves, the banks were suddenly following the lead of the ANZ and acting independently of the Reserve Bank. The Reserve Bank’s price leadership role was on this occasion taken over by the ANZ. The banks appeared to be following an oligopolistic tactic designed to create monopoly profits. While formal cartels are, of course, illegal, if the actions in setting price are the result of tacit collusion, rather than formal decisions, there is really nothing the regulatory authorities can do under existing laws.

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[17] See for example, The Australian Government (2012) *Business Tax Working Group: Final Report*, 1 November.

[18] The theoretical monopoly price is the price that maximises the profit for the whole group.

[19] Riley, G (2006) ‘Oligopoly – Overview’.

[20] There was also an equal increase in interest rates on loans to small business, but a reduction of 15 basis points in fixed interest mortgage rates. One basis point is 0.01 of one per cent.

The government has legislated to prevent the most obvious forms of price signalling between the banks that we used to see when bankers talked out loud about what they might do under different hypothetical circumstances.[21] There is, however, another form of price signalling that is harder to address – the practice whereby banks let it be known that they are targeting a particular rate of return on equity. Some years ago a former governor of the Reserve Bank noted that the banks had been targeting rates of return of 18 to 20 per cent – and these targets were after-tax figures.

The big problem faced by the firms in an oligopoly structure is that of holding each firm to the agreement or implicit strategy. There is always the temptation for an individual member to break away from the group behaviour, undercut the price charged by rivals and try to expand its share of the market in order to increase profits. Collectively the oligopolists cannot do better than the price a monopolist could set, but individually they can.

That is exactly what the NAB tried when it announced its 'break up' with the other big four banks in February 2011 as part of a campaign promoting its mortgage interest rates as the lowest.[22] The attempt by a member of a group to break free is beneficial to consumers. In principle the government can encourage participants to break the power of an oligopoly by encouraging competition. Some initiatives have been made in that direction but basically governments' reliance on competition has not made any real dent in bank profits or concentration.[23]

Competition issues

An earlier study on bank profits by The Australia Institute, *Money and Power,* stressed that the banking industry is very concentrated and found that the top four banks controlled 75.7 per cent of all banking when measured by assets (mainly loans and advances). That lack of competition is exploited by the big banks, which are intent on maximising profit. This is just as the textbook firm with market power would be expected to behave.[24]

In contrast to the findings in *Money and Power*, the CEO of Westpac, Gail Kelly, said that the banking industry 'is a strongly competitive environment even among the big four – there is a lot of competition there'.[25] When people like Ms Kelly talk about competition, it is likely that they have in mind the day-to-day struggle with their rivals for market share. For example, the big four banks spend huge amounts on advertising and no doubt much more on designing new products, processes and tactics. The most recent figures for bank advertising are given in Table 4, which shows that the big four banks spend over a billion dollars a year on advertising.

[21] Woolford, D (2011) 'Crackdown on price signaling introduced'.

[22] Johnston, E (2011) 'NAB ads put noses out of joint'.

[23] See Richardson, D (2010).

[24] Readers may object to the use of the terms 'monopolists', 'monopoly' and related terms to describe the banks. It is not suggested here that any one bank is an absolute monopoly. The term 'oligopoly' is often used to describe industries such as banking. However, the word oligopoly is less well understood by the general reader and, in any case, the players in an oligopoly are motivated to join forces and act like a monopoly. Hence the term 'monopoly' is used here as readily understood shorthand for a market player that can exercise a degree of market power.

[25] Crowe, F, Liondis, G and Walsh, K (2010) 'Big bank profits hit $22bn'.

Table 4: Big four banks' advertising expenses 2012

	$million
ANZ	229
Commonwealth Bank	459
NAB	181
Westpac	147
TOTAL	1,016

Source: Banks' annual reports

The type of competition observed in banking is not unusual. Under the domestic two airline policy, TAA (sold in 1996 to Qantas) and Ansett Airlines were involved in 'fierce competition', but not on price – the thing that really matters to consumers. This is typical of oligopolies – price competition is avoided and instead competition takes the form of product differentiation, image building and the pursuit of 'brand loyalty'. Indeed, sellers in an oligopoly avoid price competition through such devices as making prices look very complex, so that consumers find it difficult to compare product prices.

Another feature of oligopolistic competition is the strategy of competing not only in the main markets but in the niche markets as well. The major motor vehicle producers each attempt to fill all the niches; the small vehicle segment, the luxury segment, the sports segment, sports utility vehicle segment and so on. Something similar seems to be happening with the big banks. Westpac in particular seems to have a strategy of buying up branded competitors and continuing to operate as separate identities or sub-brands to provide an alternative to Westpac itself. CEO Gail Kelly, when giving evidence to a Senate committee on bank competition, explained the strategy very well. Kelly said:

> *In the Westpac Group …our strategy is one of offering customers choice through our multi-brand model, our key retail brands being Westpac, St George, Bank SA and RAMS. Each designs and implements their own customer strategies and plans. They have different marketing approaches, and it has become increasingly clear to us that they attract different types of customers.*[26]
>
> *[W]e find that customers who choose St George are not the customers who would choose Westpac. There is very little overlap there.*[27]
>
> *It is more different attitudinal approach. The customers who have chosen St George do not want to bank with a major bank.*[28]

[26] Kelly G (2011) 'Transcript of evidence', Senate Economics Committee Inquiry into competition within the Australian banking sector.

[27] Kelly G (2011), p. 86.

[28] Kelly G (2011), p. 88.

Kelly has repeated this view more recently, saying:

> *There are a range of customers, as we know, that choose St George over Westpac. If we didn't have a St George, they wouldn't choose to bank with us… It gives us an opportunity to win more customers.*[29]

Now St George for example is just a group within Westpac and we could ponder the propriety of presenting St George as a genuine alternative to those who do not want to bank with the big four. Westpac also operates the Bank of Melbourne and BankSA in a similar way. The Annual Report also refers to Westpac Institutional Bank which undertakes specialist business services and appears to have its own identity.

The Commonwealth Bank has also retained the separate identity of BankWest as a wholly-owned subsidiary. The above quote from Kelly mentioned RAMS, originally a home mortgage originator, which seems to have branched out and now accepts deposits and acts as a bank. The Commonwealth Bank, using a similar strategy, now owns 33 per cent of Aussie Home Loans – whose chief business is described as 'mortgage broking' in the Commonwealth Bank's annual report.

In another strategy the NAB launched UBank 'to compete for the "self-serve banking" customer segment'.[30] At the regional level, Bendigo and Adelaide Bank, formed as a result of a merger, is maintaining the separate identities of the Bendigo Bank and Adelaide Bank as well as its subsidiaries, Bank of Cyprus Australia Limited and Rural Bank Limited, and promoting 'independent' community sector banking. In announcing the acquisition of the Bank of Cyprus Australia, Bendigo said it 'is the largest Hellenic bank in Australia with a strong track record of growth driven by successful community engagement and customer satisfaction'.[31] Bendigo and Adelaide Bank appear to be adopting the Westpac multi-brand model. In the meantime, Bank of Queensland has purchased a number of building societies such as Pioneer Permanent Building Society Limited, Home Building Society Ltd and Home Financial Planning Pty Ltd.

Common ownership of the big banks

The increasingly concentrated nature of banking in Australia, where big banks act as a coordinated oligopoly using price leadership, has obvious adverse consequences for consumers. Yet the competitive situation may in fact be much worse, as indicated by the press reports referred to above about NAB shareholders pressuring the bank to move back in line with the other big banks' interest rates so as to preserve the profits associated with synchronised pricing.

That press story raises the question of whether the NAB shareholders concerned failed to understand the potential benefits to NAB of the 'break-up' strategy, or whether they had a conflict of interest and were more concerned with the average level of profits for all of the big banks. It is necessary to examine the ownership structure of the big banks if their behaviour is to be understood.

When we look closely at who owns the big four banks it becomes clear that there is a lot of common ownership, suggesting that those banks may not in fact be independent, competing entities. For example, examination of the top 20 shareholders in the banks' annual reports shows that HSBC Custody Nominees

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[29] Johnston, E (2012) 'Kelly rejects multi-branding critics'.

[30] National Australia Bank (2008) 'NAB unveils UBank'.

[31] Bendigo and Adelaide Bank (2011) 'Bendigo and Adelaide Bank agree to acquire Bank of Cyprus Australia'.

owns 18.88 per cent of the ANZ, 14.10 per cent of the Commonwealth Bank, 17.25 per cent of the NAB and 16.68 per cent of Westpac. The Appendix lists the top 20 owners of the big banks as well as the share of each bank they own. Table 5 below provides a summary showing the top four owners of each big bank.

Table 5: Big four banks and their top four owners, 2012

Owners	ANZ	CBA	NAB	WBC	Average
	%	%	%	%	%
HSBC Custody Nominees	18.88	14.10	17.25	16.68	16.73
JP Morgan Nominees Australia Limited	15.65	11.13	14.47	13.06	13.58
National Nominees Pty Limited	13.09	8.53	11.25	10.03	10.73
Citicorp Nominees Pty Limited	1.79	4.18	4.91	4.31	3.80
Other top 20 owners	10.27	7.19	7.04	8.74	8.31
All other shareholders	40.32	54.87	45.08	47.18	46.86
Total	100	100	100	100	100

Source: Annual reports.

From the table we can see that HSBC Custody Nominees owns very substantial shares in each of the big four banks and is the biggest shareholder in each case. Indeed, it owns over 15 per cent in three of the big four. That figure is significant, as it is the limit for any individual shareholding in a financial institution (unless permission is given by the Treasurer) under the terms of the *Financial Sector (Shareholdings) Act 1998*. Apart from the top four shareholders here, an inspection of the data in the Appendix shows that most of the 'other top 20 owners' are companies with a stake in more than one big bank.

Using the example of the ANZ, the Appendix shows that the top 20 shareholders in the ANZ own 59.68 per cent of its total shares and only one of those, ANZEST Pty Ltd (Deferred Share Plan a/c), does not appear in the top 20 shareholders of the other three banks.[32]

On average, over 50 per cent of each big bank is owned by shareholders that are among the top 20 shareholders in *all* the big banks. If we had access to the whole share register in each bank, it is likely that we would see an even higher degree of common ownership than these figures suggest.

The figures in the table raise significant questions. Given that ownership is concentrated in companies which own more than one bank, what are the attitudes of the owners to genuine competition between the banks? Someone owning shares in all four banks would want them all to do well; the best the banks can do collectively is to form a de facto monopoly through synchronised pricing. In theory a company's management is merely the agent of the owners of the company, so, how is the common ownership reflected in instructions given to management? If two or more listed banks are owned by the same large owners, are common objectives transmitted to the managements of the banks?

[32] As its title suggests, ANZEST Pty Ltd (Deferred Share Plan a/c) is likely to be a vehicle used to hold shares for the ANZ that it wishes to hold before granting them to its employees.

The evidence of investor pressure on the NAB raises concerns that the concentration of common ownership in the big banks is indeed tempting shareholders to urge those banks to act collectively.

The fact that the common ownership of the big banks mainly occurs through nominee companies is significant, because nominee companies are essentially a vehicle for holding shares by some entity or entities which do not wish to be known as the shareholder.

What about the regional banks?

There are of course alternatives to the big four banks and many people seem to be attracted to the three main regional banks; Bendigo and Adelaide Bank, Suncorp-Metway[33] and Bank of Queensland. But an examination of these banks' annual reports indicates that they too are owned by the same institutions that own the big four banks. Table 6 presents the data for the top four owners of the three regionals as well as an average of the top four owners of the big four banks.

Table 6: Top four owners; big four and regional banks, 2012

Owners	Big four average	Bendigo	Suncorp	Bank of Queensland
	%	%	%	%
HSBC Custody Nominees	16.73	11.56	21.69	9.16
JP Morgan Nominees Australia Limited	13.58	9.38	19.60	11.51
National Nominees Pty Limited	10.73	7.45	15.20	13.99
Citicorp Nominees Pty Limited	3.80	3.39	7.23	2.97

Source: Company annual reports.

These figures are remarkable, demonstrating the same pattern we observed in Table 5, which listed the top four owners of the big four banks. The first column gives the average ownership of the big four banks by the institutions listed at the left of the table. The remaining columns show the share owned in the regional banks by those institutional investors. National Nominees Limited, a wholly owned subsidiary of the NAB, holds a 7.45 per cent share of the Bendigo and Adelaide Bank, 15.20 per cent of Suncorp and 13.99 per cent of Bank of Queensland.

While we tend to distinguish between the big four and the other banks, the figures in Table 6 prompt questions about the genuine independence of the larger regionals.

[33] Suncorp-Metway Limited is in turn owned by Suncorp Group Limited.

Do bank profits come back to consumers through super funds?

In the eyes of some industry players the issues raised in this paper are largely irrelevant. Yes, they agree, big banks are profitable, but profit goes back to ordinary Australians through the dividends banks pay to their shareholders, at least their Australian shareholders.

As the ABA expressed it:

> *An estimated eight million Australians hold shares, either directly or indirectly, in an Australian bank. So you are probably one of the owners of our banks.*
>
> *Over one and a half million Australians have invested their savings directly in bank shares. These shareholders include tens of thousands of retirees, many of whom rely on the dividends from their bank shares for support income.*
>
> *Then there are the estimated eight million Australians who, through their superannuation schemes or managed funds, are saving for retirement.*[34]

The big banks often resort to the argument that their customers benefit due to their superannuation, with examples occurring in the recent round of half-yearly profit announcements. In announcing its record half-year profit on 2 May, ANZ chief executive, Mike Smith, said rising bank profits would benefit everyone with superannuation.[35] Likewise on 5 November 2012 Gail Kelly said

> *Our strong balance sheet and sustainable earnings performance allows us to return three quarters of our profit as dividends to shareholders, the vast majority of whom are Australians owning shares directly through their superannuation funds.*[36]

Super funds and bank ownership

The nominee structure of bank ownership severely restricts what we can learn about the banks' ownership. However, the question of what the super funds own can be tackled indirectly. At June 2011, super funds with more than four members had assets of $889.5 billion and 29 per cent of those were allocated to Australian shares.[37] Super funds hold big four bank shares worth $57 billion, or about a third of the banks' capitalisation, if we assume that the funds hold bank shares in proportion to their capitalisation on the Australian stock exchange – 22 per cent.[38]

There are only about 15 nominee companies in Australia, compared with the 289 super funds for whom APRA provides quarterly data.[39] The nominee structure therefore provides a means of concentrating the shareholdings of the various super funds together with, of course, all sorts of other owners who do not wish to be identified: other fund types, foreign owners and so on.

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34 Australian Bankers' Association (2004) 'Bank profits'.

35 AAP (2012) 'ANZ unlikely to pass on full rate cut'.

36 Westpac (2012) *Full year results, 2012*.

37 APRA (2012) Annual Superannuation Bulletin.

38 Market capitalisations by value and share of the ASX are obtained from E*trade data at cob 13 March.

39 APRA (2012) Statistics: Superannuation fund-level profiles and financial performance.

To make sense of this line of reasoning we need to note that the amount of profit that the big four make out of the average Australian, based on Table 3, is $1,460 per person.

This profit figure of $1,460 per person can be compared with the likely returns to individuals through their superannuation balances. Before examining the position of those with superannuation, we note that the ABA's own figures imply that there are 20.5 million Australians without any shares in the big four banks and of those, 17 million would be people aged 15 or more. This means that at least 92 per cent of the population of workforce age would not get any direct benefit.

For many of the other 1.5 million people who own shares, the returns may not be all that large. We can get some idea of individual shareholdings in the big banks using the example of the Commonwealth Bank. Those figures are presented in Table 7.

Table 7: Commonwealth Bank shareholdings, 2012

Range of shares held	No of shareholdings	Per cent of shareholders %	No of shares	Per cent of issued capital %	Average held
1 – 1,000	582,237	73.85	193,135,224	12.13	332
1,001 – 5,000	181,331	22.99	376,625,834	23.66	2,077
5,001 – 10,000	17,459	2.21	119,547,918	7.5	6,847
10,001 – 100,000	7,466	0.95	141,474,372	8.89	18,949
100,001 and over	216	0.03	761,371,432	47.82	3,524,868
Total	788,709	100.00	1,592,154,780	100	2,019

Source: Commonwealth Bank annual report.

In the Commonwealth Bank there are a total of 788,709 individual shareholdings and over three-quarters of those shareholders are concentrated in the ownership range of one to 1,000 shares. Those shareholders own an average of 332 shares, which at recent prices (approximately $57) would be worth $18,900. Based on dividend announcements over the last 12 months, the shares are generating incomes of $3.34 each. So the average small shareholder in the Commonwealth Bank owns shares generating dividends of $1,109 per annum. That shareholding is almost sufficient to offset the average yearly 'charge' of $1,460 on individuals imposed by the banks' profits.

To be fully compensated for the profit per person earned by the big banks, an individual shareholder would have to have 437 shares in the Commonwealth Bank, or roughly the equivalent in the other banks. It is difficult to be certain, but it would appear that at least half of these 1.6 million shareholders would fail to receive a net benefit from the banks. We now turn to those who might gain indirectly through their ownership of the big banks via superannuation funds.

The distribution of superannuation balances is heavily skewed in favour of high income earners and those whose balances have been accumulating for some time. Because of the skew towards high income earners we examine the median balances, as opposed to the mean, as they are a better indication of the balance in the account of the 'average' person of workforce age.

Among all people with superannuation in the accumulation phase, the median balance in 2007 was $23,698 (by comparison the mean is $70,670).[40] Since that survey was taken, the value of superannuation assets has increased by 21.4 per cent,[41] but the labour force has also increased by 10.5 per cent. That suggests the funds per person have increased 9.9 per cent.

Given the size of the super balances, we can estimate the benefit these people will receive from their share of bank profits. On average, superannuation funds have 40.3 per cent of their funds invested in shares. Given that approximately 22 per cent of the stock market is accounted for by the big four banks, that means the median holder of superannuation is likely to hold bank shares worth around $2,308. As of the close of business Friday 11 May, a fund that held bank stocks in proportion to their index weight would have earned a weighted average annual dividend over the last 12 months of 6.16 per cent, or $142. This figure, of course, falls a long way short of the $1,460 value of bank profits per adult person in Australia.

Given that people accumulate superannuation for use in retirement, it might be argued that we should examine what people are earning through their bank shares closer to retirement. The median superannuation fund balance among those about to retire is $71,731 (with a mean of $164,679),[42] which means that the median holder of super is likely to hold bank shares worth around $6,360. These shares would have earned a weighted average annual dividend over the last 12 months of $414, still far less than the $1,406 profit the banks extract from the average Australian.

All the evidence examined in this section suggests that only a few people who own large numbers of shares, either directly or indirectly, will gain more from their distribution of the bank profits than they are likely to pay as their share of bank profits. Even then the argument is a nonsense one. There can be no justification for gouging customers, no matter who ultimately receives the benefits.

One final point is worth making here as an aside. Years ago a former governor of the Reserve Bank, Ian Macfarlane, explained that by aiming for very high rates of return the banks were choosing not to invest in operations that would have been profitable, but were not able to reach profit hurdles of 18 to 20 per cent, or 26 to 29 per cent before tax. One consequence was that the big banks closed branches that were still profitable, but not profitable enough.[43]

Banks have made it less convenient for customers to undertake their banking even though the branches in question remain profitable. This is a serious problem and is not unique to banks. Investment is a major contributor to Australia's economic growth and the rise in living standards over time. In a competitive market we expect that

[40] ABS, (2009) Employment Arrangements, Retirement and Superannuation, Australia, April to July 2007.

[41] ABS (2012) *Managed funds, Australia, June 2012*.

[42] Figure is for people aged 55 to 64 years.; ABS, 2009. Employment Arrangements, Retirement and Superannuation, Australia, April to July 2007.

[43] See Macfarlane, I (1999) 'Transcript of evidence', House of Representatives, Standing Committee on Economics, Finance and Public Administration Inquiry into Reserve Bank of Australia.

businesses will invest so long as they make a reasonable return. However, the banks put such a high hurdle on investments that they ignore investment opportunities that would otherwise contribute to overall wellbeing in Australia. This illustrates one of the many ways in which the existence of monopolies acts as a burden on the economy as a whole.

What about competition from mutual banks, credit unions and building societies?

Since the trend towards deregulation in the 1980s the mutual banks, credit unions and building societies have experienced smaller and smaller shares of the total market. One explanation for this is undoubtedly the aggressive advertising and other marketing strategies employed by the big four banks. To be fair to the big banks, another part of the answer must be that economies of scale in banking, meaning size itself, generate a competitive advantage. Nevertheless, a number of mutual banks, credit unions and building societies often offer very competitive interest rates vis-a-vis those of the big four banks.

While there is no time series of representative interest rates on credit union and building society loans, a recent study by Canstar, a private website that compares interest rates, found that mutuals were consistently cheaper than the big four banks over a three-year period by 40 basis points (0.4 per cent).[44]

On 5 November 2012 the cheapest standard variable loan available from the big four banks was 6.58 per cent from the NAB. The NAB is, as pointed out above, the bank that has, as part of its marketing strategy, tried to distinguish itself from the other banks by offering the lowest mortgage interest rates of the big four. Nevertheless the NAB interest rate is a good deal more expensive than those offered by many individual mutual banks, credit unions and building societies and is more expensive than the average of the mutual banks, credit unions and building societies by 38 basis points.[45] That figure confirms the earlier study by Canstar and it is important to work out what this small difference in interest rates can mean to the consumer when compounded over the life of a mortgage.[46]

The NAB and average mutual banks, credit union and building society interest rates were both run through an online mortgage calculator, in this case the ANZ online calculator. The results are shown in Table 8 below.

If the present differential persists over time, then the average mutual bank, credit union and building society customer will save $7,163.76 over the life of the loan for every $100,000 they borrow. That is the result of saving $23.87 per month. Of course the actual cost to individuals depends on the value of the loan.

[44] The Canstar reference was reported in Denniss, R and Baker, D (2012). ‘Who knew Australians were so co-operative? The size and scope of mutually owned co-ops in Australia’. A basis point is 0.01 of one per cent, so 40 basis points is 0.40 per cent.

[45] An average was taken of all the providers listed in Canstar that appeared to be a credit union, building society or mutually owned bank.

[46] As an aside, vis-a-vis the power of compound interest one is reminded of Keynes’s whimsical remark that had Queen Elizabeth the First invested the gold plundered from the Spanish at a fairly low rate compounded over future years, England would have paid for all its foreign assets by 1930. Keynes also observed ‘every £1 which Drake brought home in 1580 has now become £100,000. Such is the power of compound interest!’ The results here are less dramatic than those of Keynes, but are powerful nonetheless.

Table 8: Home loan repayments on $100k: credit unions and the cheapest big four bank

Repayments: $100,000 standard variable home loan over 25 years with monthly repayments		
	Total repayments over life of the loan $	Monthly repayments $
NAB	204,064.38	680.21
Average credit union or building society	196,900.62	656.34
Difference	7,163.76	23.87

The average value of new housing finance commitments for the construction of, or the purchase of, new or established dwellings in the year to September 2012 was $301,520.[47] On that loan the customer would save $71.97 per month, $963.67 per annum or $21,600 over the term of the loan if the differential was maintained. The weekly saving is $14.75, or around one and a half times the expected additional cost of carbon pricing, which it is estimated will cost the average household $9.90 per week.[48]

Conclusion

The Australian banking system is not as competitive as it could be. The big banks themselves try to put the case that they operate in a competitive industry, but admit that they could be more competitive; however, they claim that more competition would undermine the stability of the system.

To put the banks' position in context, the paper examined some of the long-term trends. In the post-war period credit unions, building societies and other non-bank financial institutions made inroads into the banks' market share, almost reaching 50 per cent of total business as measured by lending statistics. However, since the 1980s the banks have fought back and they now control over 90 per cent of all lending. While the banks have become progressively more dominant in the financial system, among the banks themselves the big four have increasingly taken market share from the other banks. In the mid-1990s the big four banks accounted for almost two thirds of all bank lending and about two thirds of home loans. That has now increased to over 80 per cent of total lending and almost 90 per cent of home lending.

Given the increasing concentration of finance in the banking system and the concentration of banking with the big four banks, it might be expected that the profits of the banking system would also increase. This has indeed happened, so that while pre-tax profits of the big four banks were 0.7 per cent of GDP in 1986, the most recent figures show that they have risen to 2.3 per cent of GDP.

Against the claim that the big banks are competitive, there is evidence in our banking industry of oligopolistic competition involving non-price strategies typically employed by oligopolies – Westpac and Bendigo bank in particular are developing multi-brand

[47] TAI calculations based on ABS (2012) *Housing finance, Australia, Sep 2012*.

[48] Australian Government (2012) Working together for a clean energy future.

models that allow these parent companies to corner the independent banking market. With respect to price leadership, until recently the banks let the Reserve Bank act as the price leader but in February 2012 the ANZ took on that role. The dominance of the big four banks in the market makes it easier to develop informal understandings that they will not unilaterally reduce prices. But the decision by the NAB to break ranks was seen by some of its investors as a threat and they urged it to move back in line with the ‘competition’. To understand the degree of competition in the banking system it is important to understand bank ownership. This paper presents evidence on the pattern of bank ownership in Australia.

An inspection of the top 20 shareholders in the big four banks reveals a very interesting pattern. On average, over 53 per cent of each big bank is owned by shareholders that are among the top 20 shareholders in *all* the big banks. Most of the owners, and certainly the top four shareholders, are nominee companies. Nominee companies hold shares on behalf of other entities that for some reason want to hide their identity. They tend to be both foreign investors and fund managers; increasingly they are investors acting on behalf of superannuation funds.

The common ownership of the big four banks seriously challenges the idea that there are four separate big banks in Australia. Given the common ownership of the big banks, it is to be expected that the owners will put pressure on the banks to act as one and reap the monopoly profits. That seems to have been the motive of the investors who encouraged the NAB to move back in line with its competitors. Moreover, ownership figures for the second tier banks, the big three regionals, show they are also owned by the same organisations that own the big four.

The big banks argue that, even if all this is true, they are owned by the people of Australia, either directly on the part of some bank shareholders or indirectly via people’s superannuation funds. This paper has examined that proposition and found it to be misleading at best. There are around nine million adults in Australia who have neither shares nor superannuation. On the bankers’ figures, only 1.5 million have bank shares – so if ordinary people are going to have a stake in bank profits, it will be through their superannuation. The average person with a superannuation balance is, however, only likely to get a benefit of around $142 per annum as a result of bank profits. By contrast, the average profit extracted by the big four banks from adult Australians is $1,460 per annum. Even if we think it legitimate to compare the costs imposed on Australians via massive bank profits with the benefits they receive through dividends, the imbalance experienced by the average Australian is close to 10 to one.

There is, however, a way to avoid adding to the excessive profits of banks: by shopping around and comparing the costs of banking with the mutual banks, credit unions and building societies. At the moment the average standard variable home loan interest rate offered by the mutual banks, credit unions and building societies is cheaper than the cheapest of the big four banks. Taking the value of the average new housing finance commitment, the average mortgagee would save $16.61 a week, or about 1.5 times the expected costs to the average household of the carbon tax. Of course, the savings would be much higher if homebuyers dealt with the cheapest mutual banks, credit unions and building societies.

Appendix

Table 9: Big four banks and their owners, 2011

Owners	ANZ	CBA	NAB	WBC	Average %
AMP Life Limited	0.96	0.87	0.76	0.93	0.89
ANZEST Pty Ltd (Deferred Share Plan a/c)	0.66				0.17
Argo Investments Limited	0.29	0.17	0.22	0.30	0.25
Australian Foundation Investment Company Limited	0.30	0.54	0.41	0.59	0.46
BNP Paribas Noms Pty Ltd	1.00		2.73		0.93
Bond Street Custodians Limited		0.33		.37	0.18
Citicorp Nominees Pty Limited	1.79	4.18	4.91	4.31	3.80
Cogent Nominees Pty Limited		2.20		2.66	1.22
HSBC Custody Nominees	18.88	14.10	17.25	16.68	16.73
Invia Custodian Pty Limited		0.16		0.20	0.09
JP Morgan Nominees Australia Limited	15.65	11.13	14.47	13.06	13.58
Milton Corporation Limited		0.19		0.34	0.13
National Nominees Pty Limited	13.09	8.53	11.25	10.03	10.73
National Australia Trustees			1.09		0.27
Navigator Australia Ltd		0.17	0.22	0.21	0.15
Perpetual Trustee Company Limited	0.26	0.15	0.28	0.26	0.24
Queensland Investment Corporation	0.21	0.19	0.35	0.20	0.24
Questor Financial Services Limited		0.14		0.15	0.07
RBC Dexia Investor Services Australia Nominees Pty Limited and RBC Global Services Australia Nominees Pty Limited	0.74	1.24	0.55	1.44	0.99
UBS Nominees Pty Ltd; UBS Wealth Management Australia Nominees Pty Ltd; and UBS Private Clients Australia Nominees Pty Limited	0.41	0.58	0.43	0.73	0.54
Total	59.68	45.13	54.92	52.82	53.14
Total percentage that own shares in at least three banks	57.58	41.85	51.10	48.74	48.57
Total percentage that own shares in all four banks	52.58	41.68	50.88	48.53	50.49

Source: Big four banks' annual reports 2012.

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