Where next for financial services?

How Australian financial services can reboot, and help reboot Australia

2020

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In the years to come, nine critical forces will amplify change in all sectors of the Australian economy, and financial services (FS) is no exception. To meet the challenge, banks, insurance providers, super funds and asset managers will have to address challenges to every part of the enterprise, from their customer-facing front end to the productive stewardship of risk and balance-sheet, on through the management of the core pillars of the institution: people, technology, operations and other infrastructure.

Financial institutions (FIs) will have to do all this as they continue to support their clients – the rest of Australia – through similar transitions of their own. In the years ahead, they will be critical protagonists in a profound national project: rebooting Australia. Through their unique role in the commercial ecosystem, they will be essential partners to Australian households, businesses and other institutions as they grapple with the nine forces described in our report: Australia Rebooted. Done well, this can help craft a more sustainable, expansive and prosperous vision for Australia, and then help shepherd capital, people and other resources towards it. It's a kind of moment for which this industry was made.

Introduction

As lockdown restrictions ease, the strategic focus within the banking, insurance, super funds and asset management sectors ('financial services', or 'FS') is shifting toward the question of how to succeed in a post-crisis world and what role the industry must play in the Australian economy. Far from being a resumption of business as usual, the industry, along with the rest of Australia, will be finding its way in a completely new environment. For FS, things such as digitisation, workforce transformation, innovation of offer, business model and collaborative operating platforms will be fundamental to reinvigorate growth and keep pace with rapidly-evolving market expectations.

The choices FS leaders make will have profound and lasting implications on the future of the industry – as well as the trajectory of the Australian economic 'reboot.' This calls for industry leaders to revisit not only the economic fundamentals underlying their businesses, but also their mission, purpose and role in society. FS isn't just another industry: as the keeper and allocator of capital, enabler of savings, investment and commerce, and the transferer of risk, its role in the commercial ecosystem is especially crucial at this moment.

This FS 'deep dive' follows on from our PwC report: Australia Rebooted. That described nine forces driving change in the Australian economy and financial system, and proposed two high-level scenarios for what the future might hold. We look at these forces through a FI lens and explore the dual role FS has to play. First, it must restore sustainable growth for itself as an industry. Second, it must step up to the challenge and responsibility that follows from its unique role in the economy in shepherding the reboot of Australia. This is illustrated in Exhibit 1, and explained further in the report below.

Exhibit 1
Rebooting Australian FS

Nine forces driving change

People
- Consumer behaviour
- Productive, flexible and distributed working
- Migration

Economy
- Accelerated digitisation and data reliance
- Resilient supply chains
- Industry consolidation

Social contract
- Debt and capital
- Greater government involvement
- Tax

Imperative for FIs: Transforming self while shepherding Australia's reboot

Twelve critical areas for self-transformation

Customer connection	performance	Institutional foundation
Client/customer/member portfolio	Product and service portfolio	People and culture
Channel mix	Revenue and pricing	Operations
Brand and purpose	Balance sheet	Technology
Other stakeholders	Risk appetite	Footprint and infrastructure

Shepherding Australia's reboot

Supporting a changing Australian economy	Hunting for growth	Aussie baba: Taking Australia to the world

COVID-19 accelerated longstanding drivers of change

In Australia Rebooted we describe the forces driving change in the Australian (and global) economy, and proffer two plausible reference scenarios for our future.

Nine forces driving change

The crisis will accelerate and add to forces of change in our economy and society that have been underway for some time. The report highlights nine in particular, summarised in Exhibit 2, which are interconnected and mutually reinforcing. One can't pick and choose which ones to prioritise or address. It is therefore important to understand them as a collective, and in particular the degree to which the current crisis is likely to accelerate or otherwise alter the momentum behind them in the years ahead.

Two 'reference' scenarios for Australia's future

Australia Rebooted also envisions two high-level scenarios representing different paths we could take as a nation. One scenario, 'Fortress Australia', sees the country turn inward, reacting to fear and prioritising protection from danger. This prompts increased investment in defence, health care and domestic self-sufficiency along with a reduction in global trade and immigration. The other scenario, 'Enterprise Australia', sees the nation draw on its reservoir of optimism, openness and self-confidence to recommit to the principles that have underpinned national prosperity for three decades: commerce, globalisation, immigration, innovation and readiness to compete. This of course is the spirit behind the Government's recently-announced JobMaker plan, although it remains nascent in its development.

For the economy, the differences between scenarios are material. Our macroeconomic modelling suggests that cumulative lost output by 2030 could be as much as $340b higher in a Fortress Australia scenario than relative to Enterprise Australia.

However, under either scenario, COVID-19 and the nine forces in Exhibit 2 are going to affect all aspects of the economy, and they will affect FS both directly, as an industry, and indirectly via its effects on clients of FIs, and their obligations to them.

Exhibit 2

Nine forces driving change

People	Economy	Social contract
Consumer behaviour Indebted, digitally-native, risk aware and grounded in fundamentals	**Accelerated digitisation and data reliance** E-commerce / e-services, digital experience, infrastructure, cyber security, predictive analytics	**Debt and capital** Greater government debt across all sectors (private and public), impacting interest rates and supply of capital
Productive, flexible and distributed working Diversity of time commitment, work locations, Agile (and agile) teams and primacy of tech / specialist capabilities	**Resilient supply chains** Awareness of vulnerabilities (cross-border, geographic concentration)	**Greater government involvement** Increased role and relevance at all levels
Migration Australia's relative success in responding to the pandemic will increase desirability as destination just as crisis amplifies populist resistance	**Industry consolidation** Both consolidation around advantaged business models, and (possibly) shifts in resources and capital between industries	**Tax** Revenue from traditional channels constrained by risk of undermining growth

Forces present for some time – though current crisis accelerates and alters them

For FIs, many of these trends underlying the nine forces have existed for some time. These include lower interest rates, margin compression, increased regulatory intervention and the progressive opening of the sector to new competitors exploiting changes in technology and consumer behaviour. These are summarised in Table 1.

Table 1

Forces of change, long-standing trends amplified by COVID-19 and their implications for FS

Long-standing trend	Likely COVID-19 impact (mid-long term) for FS
People	
Consumer behaviour	
• High household leverage (debt/income) • Diminishing trust in institutions • Concentrating wealth • Shift to experience/ personalisation as a source of differentiation • Ageing society / longevity needs • Shift to digital channels • Assets shift to passive / cash • Demand for transparency • Expectation of value for money	• Leverage increased due to loss of income • Increasing risk aversion which, if it persists, impacts product choice, savings rate e.g. travel insurance, IHL volumes, retirement products • Accelerated digital adoption, decreased use of cash (now just 27%[1] of payments in Australia), branches and physical documents • Relative growth of 'liability side' (savings, investment, risk products) • FS brand reputation being reset, with almost 80% of Australian banks in March registering higher assessed trust since December 2019[2] • Increased appetite to try new products and services (e.g. in Canada, 48% of consumers have tried new brands during isolation[3]) • Increased appreciation for value of good financial planning and information (whether from advice, self-education and/or online tools)
Productive, flexible and distributed working	
• Casual/part-time employment • Agile work practices • Diverse/inclusive workforce • Changing in response to digitisation and data (above)	• Shift to work from home (WFH) going surprisingly well, though workforce and productivity still a top-3 concern for executives[4] • Employees seeking ongoing demonstration of concern for their well-being • Organisations seeking to embed focus, speed and behaviours from crisis • Executives/boards asking: "Why can't we always be that fast?" and seeking to retain 'crisis' speed in decision-making • Even greater emphasis on accountability, decisiveness and attention to customer outcomes • With employees WFH, options for who to hire/involve expands (pool becomes global) – at least for 'knowledge' work • Implications for commercial and residential property, infrastructure, incomes, credit, human capital (training, skills, recruitment and management) and repurposing of existing property/ infrastructure • Asset managers with large commercial real-estate portfolios facing asset revaluation as we work and shop in decentralised communities • Continued evolution in the gig economy will need to be supported by evolving but still rigorous credit processes in banks
Migration	
• Australia a destination of choice for skilled labour • However, undercurrent of populist resentment	• Opportunity to better serve cross-border finance needs (credit, tax, investment, insurance) • The crisis increases Australia's appeal (assuming our relative success on containing the virus continues) • However, it also potentially increases the intensity of potential popular resentment and fear
Economy	
Accelerated digitisation and data reliance	
• Digitisation and automation • Cloud-based, modular, third-party architecture (identity, data,[5] etc.) • Artificial intelligence, advanced analytics on big data	• Opportunity to increase efficiency, quality and reliability in operations (service and fulfilment), marketing, pricing, advice and risk/oversight • Urgency increased by coming recession and imperative to increase efficiency and retain revenue • Micro segmentation and pricing • Customer expectation for improved digital experiences • Managing (elevated) risk from cyber and financial crime

Long-standing trend	Likely COVID-19 impact (mid-long term) for FS
Resilient, secure supply chains	
• Global, often geographically concentrated supply chains • Headwinds to globalisation building since '00s • Populist resentment about those 'left behind' • Breaking of 'Chimerica'	• Shifting mix of trade finance across origin-destination pairs for goods and services, depending on scenario (e.g. greater localisation in physical production under 'Fortress' scenario, greater dispersion and reserve capacity under 'Enterprise' scenario, and reduction of single-source risk under both) • Shifting geography mix for asset management and risk capital • Increased appreciation for risk in supply chains which span globe but are concentrated at key 'choke points' (e.g. supply)
Industry consolidation	
• Steadily underway since market reforms three decades ago • Reasonable industry consolidation at 'top end' • Significant fragmentation remains among smaller businesses	• Within FS, minimum viable scale to invest in reform, manage margin pressure and the capital impost of potential impairment will reduce sustainability for some FIs and inevitably lead to consolidation • In industries, FIs will need to orchestrate and fund restructuring and investment, including management of a growing pool of SME equity in receivership or administration • Recession will pressure marginal franchises and business models, as supply chains disjoin and are reassembled, and as government focus, tax and immigration all change • Super funds may find new domestic opportunities attractive • Path dependent on nature of government policy and support, and on 'micro-market segments' by industry and by geography • Risk of 'structural joblessness' especially among young and under-skilled • Digitisation and changing workforce patterns may ultimately create new business models that will ameliorate forces of consolidation
Social contract	
Debt and capital	
• Pre-crisis Australian total debt high but held by homeowners • Public sector debt low • Business debt only moderate	• High pre-existing levels of personal debt (Australia 190%) will need very careful management for orderly deleveraging • Total public and private sector debt heading back to post-war highs,[6] with implications for government policy (e.g. Australia's insolvency regime), interest rates and asset values for decades to come • Interest rates lower for longer, with corresponding stress on 'asset-side' businesses (credit, asset management, insurance) • Accentuated scrutiny on promised 'alpha' given low 'beta' returns • Future GDP and productivity growth potentially even lower than past decade • Australia's access to foreign funding and capital on which it is dependent may face future scrutiny (though no sign of that to date) • Confidence in fiat currencies
Greater government involvement	
• Increased government activism (regulatory, fiscal, monetary policy) • Renewed interest in Keynesian stimulus	• States and Commonwealth key partners in recovery planning and policy • 'Reprieve' in regulatory enforcement actions, if any, to be short lived • Governments around world embracing ambitious fiscal and monetary stimulus
Tax reform	
• Tax revenue constrained by reliance upon subdued income growth • Consumption, wealth and passive income taxed less than active income (wages, bonus and tips)[7]	• Reform may challenge established businesses tied to current tax setting (e.g. property and corporates seen to pay steady dividends • Revenue constraints amplified by recession due to both falling incomes and effective rates (which fall as income falls due to progressivity) • Raising rates to compensate risks amplifying recession • Need for fundamental reform, including simplification and broadening of tax base

These implications for FS hold regardless of the long-term scenario for Australia's political economy (Fortress versus Enterprise). However, there are obviously differences. Under 'Fortress Australia,' for example, immigration is lower, potentially impacting the availability of highly-skilled staff. Tax revenues and GDP growth are also lower, while debt remains higher for longer. However, the pace of disruptive change in terms of supply chain, industry consolidation, digitisation and ways of working may be slower. Overall, cumulative Gross Value Added (GVA) for FS is expected to be $20bn less over the period to 2030 than under Enterprise Australia[8]. However, there will also be opportunities in areas like defence, manufacturing and medicine which will all require funding, capital and advice.

Of course, this is an industry-wide view. Individual sub-sector and enterprise results may vary. The question facing any individual FI is what to do now. We discuss this question next.

Imperative for FIs: Transforming self while shepherding Australia's reboot

So far in this crisis, the FS industry, in conjunction with the government, has been instrumental in supporting vulnerable customers and providing a credit lifeline for businesses. There is the real prospect of the FS industry re-establishing its role in society, and rebuilding trust. The spotlight will now shift to the way the industry treats its customers while, at the same time, balancing returns and sustainability.

To continue to fulfil its role, FIs must accelerate transformation and capture the many currents of positive momentum that are already underway; currents in digital adoption, customer behaviour, and workplace practice, discipline and focus. This means making decisions around cost to support investment, and also reallocating capacity (people, technology, capital) towards areas of growth.

The imperative for Australian FIs is twofold:

- To transform themselves to compete in the new environment, and
- To shepherd their clients and the Australian economy as it makes the same transformation.

Twelve critical areas for self-transformation

The issues raised by the nine forces mentioned above challenge all elements of an FI's strategic design, from the front-end customer connection, to balance sheet performance and management. They will affect the very foundations of FIs, including people, culture, operations, technology and other infrastructure. Exhibit 3 highlights some of the changes to be considered in each of these areas, as well as why we believe these changes will be important in the mid-to-long term.

Exhibit 3

Twelve critical areas for self-transformation – strategy design impact areas

Customer connection	Balance sheet performance	Institutional foundation
Client/customer/member portfolio Asset strained Baby Boomers and Gen X, Y, Z longing for personalisation to reflect the localised impact of change in their lives	**Product and service portfolio** Simpler product architectures; services led with innovation in new areas of need	**People and culture** Productivity 'double jump' through broad-spectrum upskilled workforce and self-directed distributed working
Channel mix Channel purpose and role of 'shopfront' to be reassessed as needs to transact versus relate change	**Revenue and pricing** Market volatility increased by dynamic pricing with interlinked algorithms required to offset cost and default risk	**Operations** Next-tier service delivery outcomes as operational norms for offshoring, team-based service models and digitisation are reset
Brand and purpose Resetting of brand reputations that is occurring now, provides head start in the mid/long term	**Balance sheet** Subdued investment returns amplifies management attention on rates of return on capital programs for growing the core	**Technology** Orientation to furthering productivity agenda - not labour displacement. Increasingly cloud based and open architected
Other stakeholders **Regulators, government, community** Greater shared destiny between, industry, regulator and leaders to deliver customer outcomes	**Risk appetite** Cyber risk now 'in bold' a part of the strengthening of non-financial risk management	**Footprint and infrastructure** (non-tech) Central HQ is now the hub as people work locally or at home, changing the purpose and value of some physical assets

The considerations in Exhibit 3 are driven by consequences of the nine forces enumerated above, some of which we describe below:

Customer connection

Client/customer/member portfolio

Clients in financial distress today will expect their FI to respond with empathy and understanding. Different clients and sectors will be impacted in different ways, requiring tailored approaches from FIs. Some will find themselves increasingly asset poor, while older Australians may find their super balances inadequate and so will need greater advice during retirement. As a consequence, there's a need for innovative products across all sectors to better suit such changing needs.

Channel mix

The COVID-19 crisis has accelerated a number of pressures on traditional channels for sales and service. Consider, for example, bank branches. Approximately 400 have been temporarily closed (~7% of total nationwide). Globally, up to 70% of branches have been closed and, in many instances, converted into distributed operations centres, calling into question both the need for branches, as well as their ongoing role relative to centralised and high-cost real estate. For their part, Australians are moving online and away from cash (reducing withdrawals from ATMs, and increasing contactless payments), and that now includes senior citizens. FIs will need to support such changes.

Brand and purpose

The current crisis creates a unique opportunity for the industry to reset its reputation. There is also risk in getting it wrong. There is a new 'social contract' evolving between the FS sector and government.

Other stakeholders

FIs will have to engage with stakeholders in new ways, making the most of collective action where possible, but also retaining competitive advantages. FIs need to adopt an integrated and coherent approach to brand, customers, communities and reputation. Meanwhile, increased attention should be paid to the role of the organisation within this broader industry ecosystem.

Balance-sheet performance

Product and service portfolio

Pressure on cost base, and the leap to greater digitisation, will require FIs to simplify product design. Commerce and health are more interconnected and interdependent than ever, so there will be pressure on product design to protect communities and economies. Some product classes are likely to be radically changed to reflect new realities (e.g. travel and related insurance); some products are likely to get renewed attention (e.g. retirement products); while, for others, expert support is going to be needed to reflect new times (e.g. financial advice). Improved robustness of product documentation including policy wording exclusions e.g. business interruption and hardship.

Revenue and pricing

Customers will be under stress and want value for money. Meanwhile, FIs will face volatile operating costs and 'lower-for-longer' interest rates. It will be crucial for FIs to understand their portfolio of business and pricing in order to navigate these pressures. Supporting customers while still generating acceptable financial returns will be vital.

Balance sheet

There is a need for managing risk in an evolving balance sheet. The COVID-19 exit position will include: stressed balance sheets; evolving products (some less relevant, some growing rapidly in importance); disproportionate performance across industries; and high levels of household debt will persist. Expect lower investment returns due to lower yields in equities, and lower-for-longer interest rates.

Risk appetite

Data and analytics are a core backbone to customer strategy and risk controls. There has been growth in alternative models (e.g. Afterpay) during the COVID-19 crisis, and community adoption will be mainstream. Yet risk aversion will prevail in some areas such changing travel preferences, impacting product selection (like travel insurance). Non-financial risks, especially risks associated with cybercrime and financial crime, need more holistic and less traditional models of credit assessment, especially in retail.

Institutional foundation

People and culture

Total productivity in Australia is not yet increasing at the same rate as technology spend. Despite greater focus on cost-out capabilities, relative productivity change overtime is negative in FS (explored in more detail later).[9] As a consequence, FIs will need to look to strategically reskill and redeploy staff, and not just displace staff.

Operations

Concepts of scale in services delivery are being challenged. There are also shifting patterns of trade across markets (geographic, product and service), which will impact on-shoring, near-shoring and off-shoring relationships. There is increasing recognition that the customer battleground will be service/relationship driven – but at an affordable cost. As a consequence, FIs are increasingly challenging uplifting service operations into better service delivery and adopting: more process automation as well as more tiered service delivery, more straight-through processing, greater emphasis on automation and completeness of coverage in risk and control frameworks.

Technology

Technology investments need to unlock productivity gains, but costs of technology are unlikely to markedly change in the mid-term. Expect greater use of cloud-based, open-architected, SaaS, PaaS solutions to drive productivity. FIs will be making overt strategic choices of participating in the value chain as an owner or procurer of digital assets.

Footprint and infrastructure

Business Continuity Planning (BCP) will place much greater emphasis on optionality for the workforce. There is a belief that the Australian services sector will more persistently move to a 'central, local, home' location model.

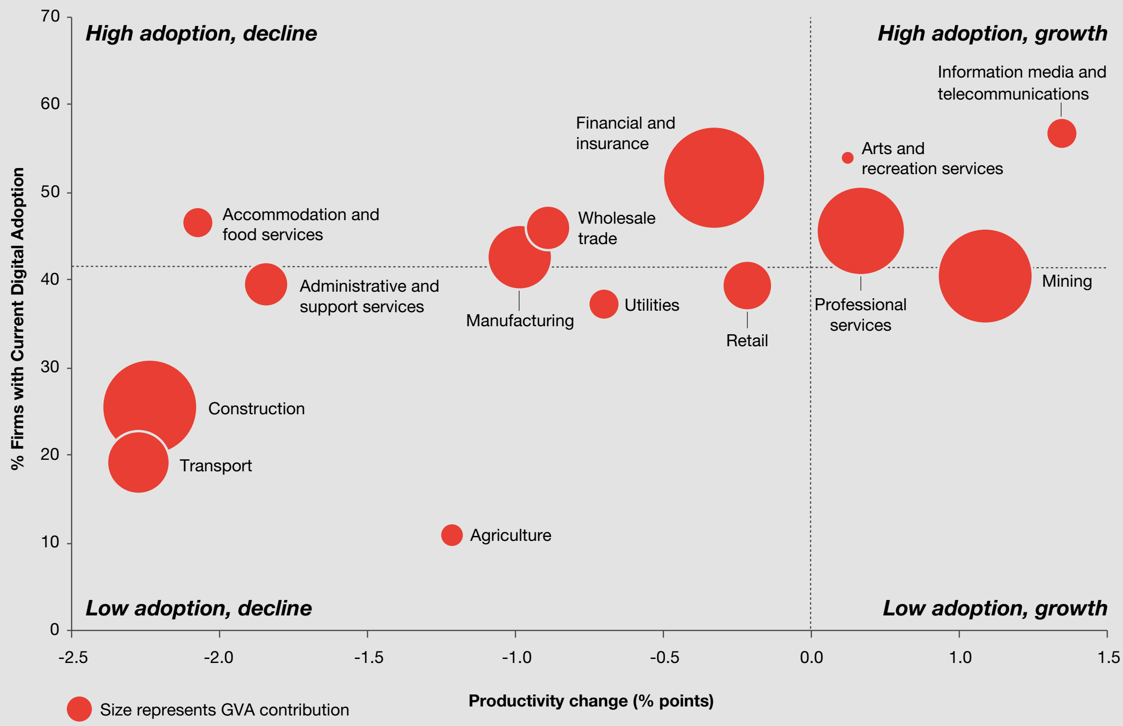
In focus: Productivity change versus technology adoption

Exhibit 4 illustrates how some of the issues discussed below interact – in this case, focusing on productivity as an example. It shows that, over the decades before and after the GFC, multifactor productivity (MFP)[10] was correlated with digital adoption, though overall productivity change has been much lower than desired (in fact, in most industries it has been less than zero).

The FS sector's digital investment has not yet translated into positive productivity change. The lack of positive change in productivity is due to both higher regulatory capital requirements, as well as significant spending on maintenance and regulatory compliance versus the development of new services and capabilities. As a result, there is a large technical 'debt' reflecting core functionality delivered by legacy systems. Finally, gaps in true end-to-end digitisation have been highlighted during COVID-19 and as FIs have enabled remote working.

Exhibit 4

Productivity change is correlated with technology adoption but lower than desired[11]



Source: ABS, "Industry Insights: Future Productivity" – Australian Government Department of Industry, Innovation and Science, PwC Strategy& analysis

Ignoring capital and focusing just on labour productivity[12] over the same period, in FS that change was lower still (-1%).

FS is a labour-intensive business, and we have yet to see the kind of breakout productivity benefit from investment in technology, restructuring, and new ways of working that we have seen recently in sectors such as professional services, mining and IMT[13]. Significant and sustained changes in behaviours and ways of working are needed to realise the potential.

The opportunity for such change is exactly what the current crisis is putting on the table. To capture this opportunity, we need to redouble focus on some basic foundations, including:

- True end-to-end digital enablement
- Upskilling the workforce and integrating digital and human elements
- Streamlining physical infrastructure and capitalising on customer adoption of digital
- Shifting investment from legacy core (where there has been substantial rearchitecting) to the middle- and customer-facing front-end to deliver real transformation in offer and experience.

Shepherding Australia's reboot

Enormous national redirection of capital, labour and attention

As in FS, every business in Australia is facing enormous challenges. So too are governments and households. As they face these challenges, they will depend on the financial system to play a critical role in the orderly reallocation of capital and credit, providing stewardship over savings and other assets, facilitating transactions, insuring against risk and, through it all, providing counsel and advice. This of course will involve every sector of the industry, including banks, asset managers, superfunds and insurance providers.

Changing Australian economy

PwC's report, Australia Rebooted, outlines the challenges facing Australia, as well as the need for support and advice for each sector. Examples include:

- **Education:** Growth will be hampered by falling exports, as a result of international students' decreased propensity to study in Australia. There will also be potential opportunities (and threats) from online learning, which will expand the addressable market by many orders of magnitude, but also potentially create a winner-take-all dynamic that leaves some Australian institutions behind.
- **Construction:** The fall in consumption and investment will reduce short-term demand, while required changes to work practices (social distancing, hygiene etc.) will impose constraints on project delivery. At the same time, the crisis presents the need for material new investment in transport, communication, health and other infrastructure. This is an enormous medium-term opportunity, especially for operators able to optimise project delivery under new, health-driven constraints.
- **Retail:** We expect an acceleration of online platform adoption, demonstration of value through lower price points and promotions, and increased agility within supply chains. Many retail businesses will not recover from the crisis, while others will require a fundamental transformation and entirely new models may prosper.
- **Tourism:** Tourism will face the same challenges as the retail sector. There will be a direct reduction in demand, regardless of scenario, as fewer people travel. However, in the medium term, Australia's appeal as a safe, healthy and hospitable destination provides the opportunity to capture a larger share of the total global tourism pie. At the same time, Australians will rediscover opportunities for travel and recreation at home.
- **Agribusiness:** In principle, Australian farmers are well positioned to take advantage of many of the trends described above, including an increasing appreciation for the value of reliable supply, hygiene and food purity. However, this is offset by the risks associated with an increasingly precarious geopolitical environment in which food policy becomes subordinated to other national considerations, both within Australia and its trading partners.
- **Energy:** The same combination of threat and opportunity confronting agribusiness is relevant for Australian energy. However, domestic energy producers must also face the possibility that the current crisis permanently alters the politics of climate change, presenting risks and opportunities for the macroeconomy that are potentially transformational. These risks and opportunities will affect energy producers, as well as derivative industries such as refining, smelting and other manufacturing.

In short, every sector faces varying risks and opportunities, and this drives differences in fundamental outlook.

Consider Exhibit 5. This shows the impacts of COVID-19 on (self-assessed) ability to pay operating expenses (x-axis)[14] against the profit margins of SMEs in those industries (y-axis), with the bubble size showing the number of SMEs in those industries. SMEs in some industries will recover more quickly from COVID-19 (e.g. construction); others will require careful management to recover effectively (e.g. retail and wholesale trade); while many will find that their ability to recover will depend on their balance sheet's ability to absorb ongoing stress (e.g. accommodation).

These conclusions differ, of course, depending on location, sub-sector, franchise and other considerations. FIs, especially lenders, need to understand all this as they gear up to support clients.

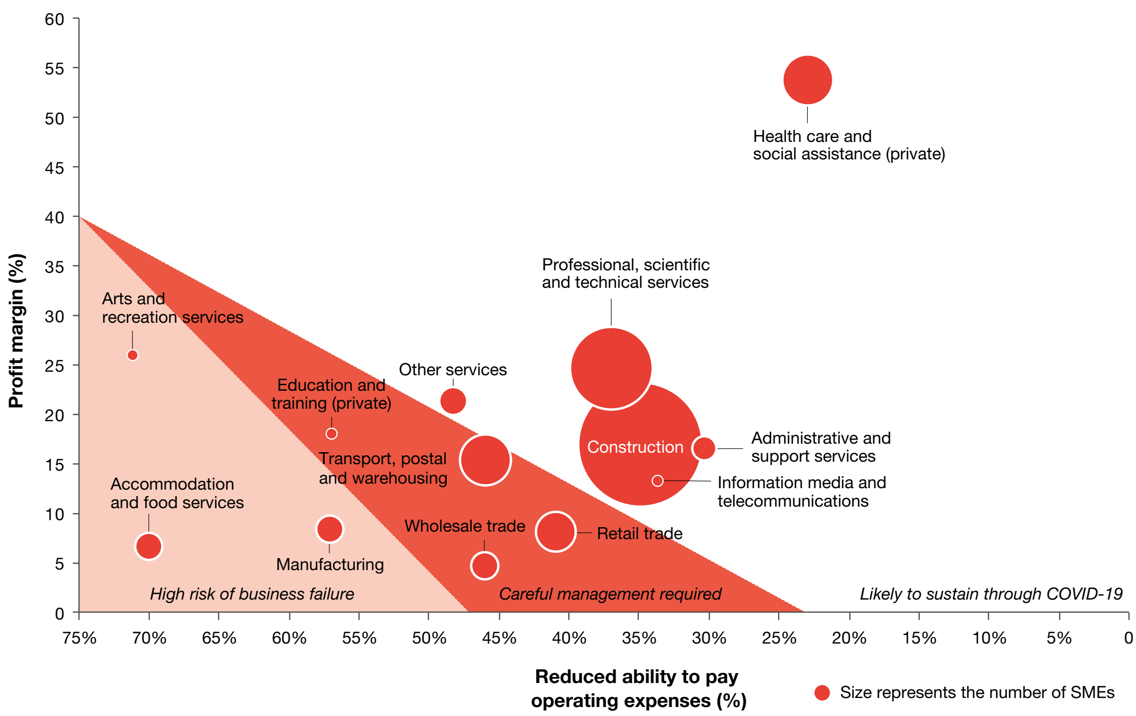
Among other things, they will need to be able to:

- Understand and target at a micro-segment level (e.g. domestic rather than international tourism in specific states),
- Have adaptable workout policies, and
- Understand how digitisation and changing workforce behaviours impact different industries.

Rigorous geospatial analytics and the ability to tailor policy and intervention precisely will be more important than ever. Fortunately, the necessary data exists, especially inside banks, and can be augmented with other information, such as payment volume data, social media traffic, Google search information and other sources to form an 'early-warning system' for the customer base and enable the micro-targeting of advice and support.

Exhibit 5

Wide variation in COVID impacts by industry[15]



Source: ABS data, Business Indicators, Business Impacts of COVID-19, April 2020

Hunting for growth

Much of the support described above concerns trends which are already underway: it's what's going to happen. Yet it's important to remember that just because the new environment creates opportunities for growth (as we believe it does), capturing it still requires deliberate intent.

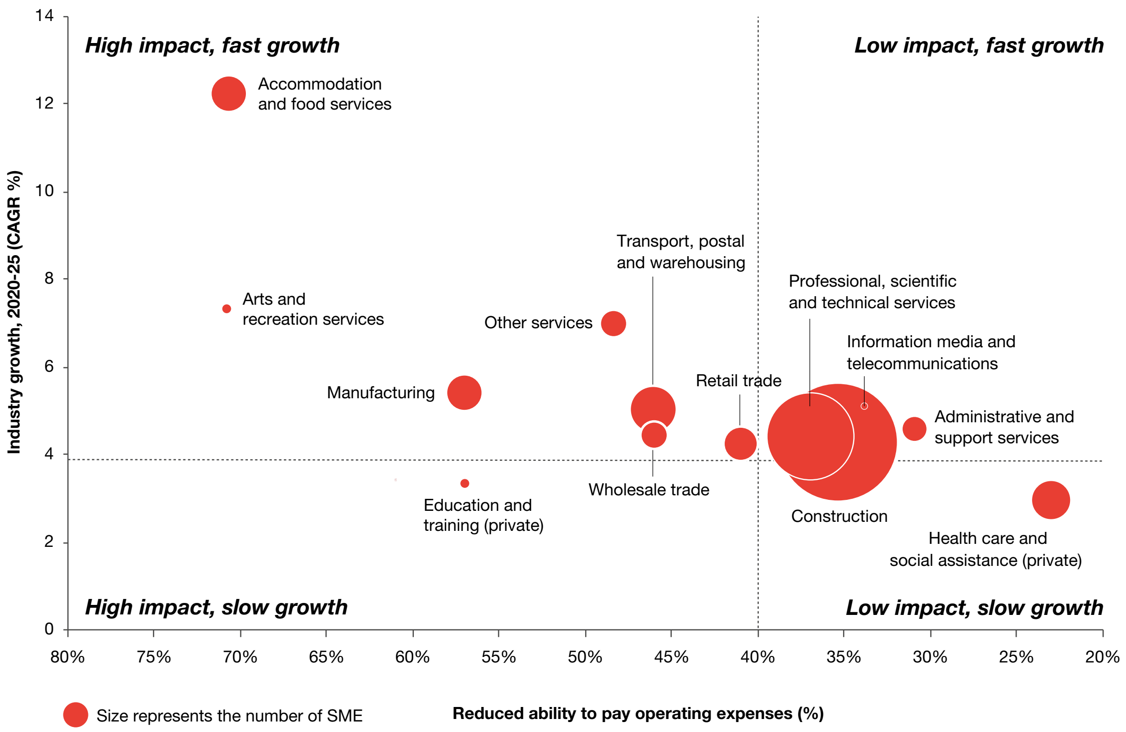
As hard as growth has been to come by in the years since the GFC, in the aftermath of this pandemic it will be harder still. As shown in Exhibit 6, many of the most vulnerable sectors in Australia are also expected to be sources of the most growth, especially among SMEs. However, with households and now the government constrained by debt and falling revenue, one has to wonder who will be in a position to increase consumption and enable that growth.

It's important to note that this is not because of a lack of underlying need. For every sector facing fundamental questions about future need (such as perhaps cruise-ships) there are others confronting a possible surge, if only customers could be found confident enough, and liquid enough, to procure it. Examples include cleaning and sanitation services, cleaner energy, water and forest management, domestic adult education, training, aged care, child care, home care, etc. There will especially be a need to retrain and re-skill workers for new jobs: not just young people who may need to rethink their career opportunities, but also older Australians who, facing materially-diminished superfund assets, may choose to delay retirement.

Unfortunately, as we learned during the Great Depression, it is possible for a simultaneous demand deficit and supply deficit (relative to need) to persist for a very long time if financial, monetary, fiscal and other settings aren't right. FS has a fundamental role to play in helping ensure that does not happen.

Exhibit 6

The most vulnerable sectors may also be the fastest-growing (Enterprise Australia scenario)[16]



Source: Australia Rebooted Economic modelling; Industry growth is the compound annual growth rate of gross value added by sector, 2020-25, PwC Strategy& analysis

Aussie-baba: Taking Australia to the world

Finally, it must be said that in this environment, not all the growth we seek can come from home. Exports will be key. In the future these must be more diverse and broad-based than they have been in the past. With the constraints described in the first section of this report being what they are, Australia must shift the focus of growth from consumption-led to supply and export-led growth. FS can help, starting with reimagining Australia competing (and winning) in areas beyond the nation's traditional areas of advantage. In doing so, funds will benefit, banks will benefit, and so too will the wider economy.

What can FIs do? There are countless possibilities, including, by way of illustration:

- Driving the deployment of Australian savings to the world's most pressing investment needs (e.g. PPP and energy infrastructure, especially in Africa and Asia)
- Deploying domestic capability in structuring private sector investment for large-scale infrastructure around the world – effectively seeking to add more value to the nation's export of superannuation system assets
- Working with the government and APRA to promote the development of a domestic market for corporate bonds, loans and asset-backed securities
- Exporting investment and wealth management services with explicit reputation for honesty, trust and transparency (doing for offshore FS what New Zealand has managed to do for its milk)
- Finding markets for all other FS and related services which are domestic but could be global, including payments and overlay services, ownership registries, and everything in which Australia's reputation for trust and reliability can be leveraged in other jurisdictions.

Obviously, opportunities like these are more aligned to the spirit of Enterprise Australia, under which export-led opportunities are most readily available, and which we see as most consistent with the government's announced recovery strategy. However, even under Fortress Australia opportunities for export and trade will still exist, and FIs will have a critical role to play in enabling them.

Conclusion

Despite the challenges and headwinds represented by the nine forces described in this report, we believe Australia can grow its way to recovery, and the FS sector has a crucial role to play. Along the way, the sector can also help build a more resilient Australia. To do that, it must of course start by facing into the implications of those forces for its own businesses, whether in banking, superannuation, asset management or insurance. At the same time, FS must recognise the crucial and unique role it must play in helping its customers, who collectively represent the rest of Australia, in doing the same.

This is its moment.

Endnotes

1 RBA Bulletin - March 2020 "Consumer Payment Behaviour in Australia"

2 Australian Banking Brand and Trust Index, May 2020

3 Strategy& Consumer Sentiment Survey Canada

4 PwC US COVID-19 CFO Pulse Survey, April 22, 2020

5 For example, Comprehensive Credit Reporting (CCR) and the Consumer Data Right (CDR) standard in Australia's Open Banking regime.

6 Commonwealth Treasury, History of Public Debt in Australia, March 2019

7 For example, Australia's top marginal rate for tax on income is amongst the highest in the world. By contrast, the Goods & service tax (GST) of 10% (5.5% effective given exemptions) is a fraction of the ~20% VAT common in the EU. Capital gains taxes, which are taxes on passive income, are discounted 50% and taxes on dividends enjoy imputation. Finally, property investors enjoy the benefit of negative gearing on their income tax, even when it is derived from activity unrelated to property investment

8 See Australia Rebooted, PwC, May 2020

9 Source: Strategy& analysis: Australian productivity (1989-2019) grew 2% while total spend on technology, product and services between 2017-2020 grew 4%

10 MFP is the growth in output in a sector that is not explained by growth in employment or capital employed on a gross value-added basis. Loosely, if employment in a sector grows 5% and capital employed per FTE grows 10% but total output over the same period grows 20%, then MFP is deemed to have risen (1+20%)/(1+5%)*(1+10%) = 4%. All data sourced from ABS dataset 5260.0.55.002, accessed at https://www.abs.gov.au/AUSSTATS/abs@.nsf/DetailsPage/5260.0.55.0022018-19?OpenDocument.

11 Productivity change refers to the difference between multi factor productivity CAGR in 1995/96-2006/07 and 2007/08-2018/19. Digital adoption refers to avg. % firms with a web and social media presence, and used paid cloud computing in 2015-16. Industries with many small businesses (e.g. agriculture) will score worse than those with fewer small businesses (e.g. telco). GVA is 2019 Gross Value Added contribution based on proportion of basic prices at current prices.

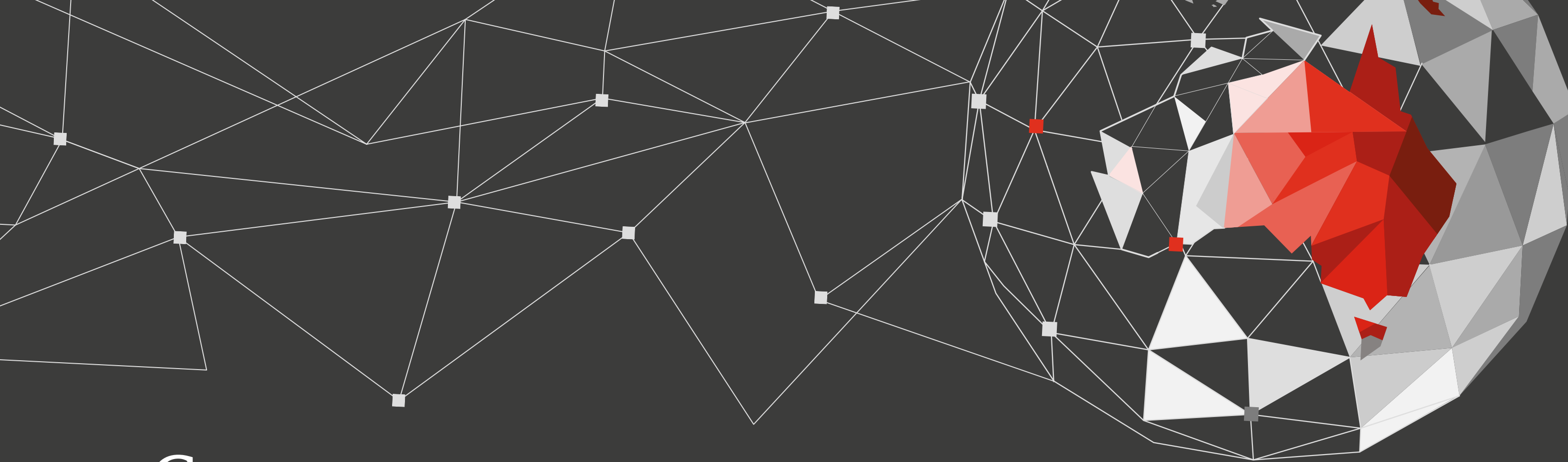
12 Labour productivity is simply GVA/FTE and measures output per employee regardless of whether that is driven by greater capital investment or some other factor. It is related to MFP in that MFP reflects labour productivity adjusted for changes in capital.

13 Information Media and Telecommunications

14 Based on responses to a survey conducted by the ABS Small Business Survey in April (see ABS Small Business Survey May 2020). Note that at the time of survey, the focus of risk was very much on the health and safety consequences of the virus. As focus shifts from the virus to the economic consequences of isolation and recession, we may find industries move along the x-axis of Exhibit 5.

15 Reduced ability to pay based on ABS Small Business Survey May 2020. Profit margin based on Strategy& PwC analysis of ABS 'Australian Industry 2017-18' data on total income and total expenses of companies with less than 20 employees.

16 Forecast growth under 'Enterprise Australia' scenario, see Australia Rebooted, PwC, May 2020. High growth occurs in industries hardest hit by COVID-19 due to growth from a low base in 2020. Also note GVA data is not split by sector, e.g. health GVA is not split by private/public, therefore a total sector GVA figure is reported. Source: Australia Rebooted Economic modelling; Industry growth is the compound annual growth rate of gross value added by sector, 2020-25, ability to pay operating expenses is estimated using the ratio of interest expenses to total expenses, ABS 8155,0 accessed at: https://www.abs.gov.au/AUSSTATS/abs@.nsf/DetailsPage/8155.02017-18?OpenDocument, PwC Strategy& analysis.



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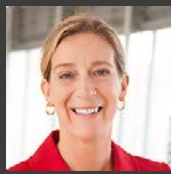

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