

Westpac New Zealand: Employee Incentives[©]

Westpac, one of New Zealand's largest banks, provides a wide range of financial services, including deposits, mortgage and personal loans, wealth management, and insurance.

The bank uses sophisticated information systems in "cross-selling", which is the marketing of additional financial services to existing bank customers, as for instance, selling a mortgage loan to a depositor.

By applying computer models to statistical information about household income and expenses, Westpac gauges each customer's capacity to re-pay. Employees are set annual sales targets and must attain at least half the target to qualify for a pay increase.

Customer service workers earn 10 points for opening a regular bank account and 25 points for selling a credit card, but relatively few points for customer service. Their target is up to 8,575 points. Consultants earn 5 points for every \$10,000 of mortgage lending and \$1,000 of personal lending, and also earn points for selling wealth management and insurance services. Their target is up to 13,305 points.

Bank workers union Finsec is concerned that the performance target scheme has created undue pressure on Westpac employees to promote loans. In December 2005, the union undertook a day of industrial action during which Westpac staff ignored performance targets when attending to customers.

By contrast, Westpac head of consumer banking, Henry Ford, contends that the target system encourages staff to understand the whole range of bank services and engage proactively with customers. He denied that the bank would overload customers with debt, "We have no vested interest in having our customers taking on more debt than they can cope with."¹

At the macroeconomic level, Governor of the Reserve Bank of New Zealand, Dr Alan Bollard called on banks to moderate their lending and avoid promoting loans to people who cannot fully repay.

However, Westpac chief executive Ann Sherry rejected Dr Bollard's call and countered that, "The reality is, you do have a market where people are insatiable in terms of demand for housing as a primary form of investment saving".²

[©] 2006, I.P.L. Png. This case is based, in part, on "Pressure to sell vexes bank staff", *The Press*, Christchurch, December 20, 2005, C4.

¹ "Pressure to sell vexes bank staff", *ibid.*

² "Pressure to sell vexes bank staff", *ibid.*

The Bank of New Zealand also subjects front-line staff to a sales-based performance scheme. ANZ National and ASB Bank are expected to follow. However, owing to their smaller size and less sophisticated information systems, Kiwibank and TSB Bank are not expected to adopt sales-based performance schemes.

Questions

1. From the viewpoint of maximizing profit, how should Westpac set points for its various services?
2. How should Westpac account for the probability that borrowers will default in designing performance incentive schemes for senior management? What problems would arise if performance incentives of senior management are related only to current sales and ignore the probability of future default?
3. Use the concept of fixed cost to explain why smaller banks have less sophisticated information systems than larger banks.