HOW BANK SWITCHING IN NZ DIFFERS BY PRODUCT: LESSONS FOR AUSTRALIA

A recent national study explored attitudes and behaviour around bank switching in New Zealand. Using that data, this paper examines the influence of the number and type of products held by bank customers on their attitudes towards switching costs and switching. It finds that some products, particularly electronic payments, increase the perception of the hassle of switching. This suggests that the focus of regulatory action needs to be on making it easier to move electronic payments.

Issues related to bank switching have been the subject of substantial public and political interest for several years. Concerns primarily relate to customers’ apparent reluctance to change banks, and the perceived difficulties faced by those who seek to change banks. Other concerns are the power conferred on banks in their relationships with their customers, and the additional costs imposed on consumers of banking services.

These concerns have led governments and regulators to seek to address the issues, and to empower consumers. In a recent example, the banking reform package introduced by the Federal Government in Australia in December 2010 was largely directed to improving competition in the banking market (Grubel 2010). One goal of the package was to strengthen the competitive position of building societies and credit unions, and the package included elements designed to encourage bank customers to switch banks, and particularly to make it easier for customers to leave the Big Four banks (see Figure 1 for details). Part of that package was the commissioning of a report into options for greater account transferability. The report, Banking services: cost-effective switching arrangements, was released in August 2011 and can be found at www.bankingreforms.gov.au.

Considerable work has been done exploring the existence of switching costs and their impact on markets and consumers, including in banking specifically. While it is widely agreed that switching costs exist in banking markets, work continues to better understand their effects and their drivers in order to contribute to discussions on how to reduce or even eliminate switching costs and improve competition. In general, switching refers to the transfer of the main banking relationship from one bank to another, but the old bank accounts may not be closed, instead becoming secondary accounts of less importance to the consumer.

Switching costs may be seen as a defensive strategy used by firms to reduce the number of customers lost to competitors. However, at the same time, they can generate monopolistic profits for firms from higher costs for customers (Ongena & Smith 1997; Padilla 1992). A Norwegian study found that lock-in of customers, resulting from the existence of switching costs, can contribute 16 per cent of the value of an additional customer (Kim, Kliger & Vale 2001). At a market level, Klemperer (1987) found that ‘switching costs cause an allocative inefficiency’ (p. 390), and that the key contributing factor to this effect is that competition between firms shifts from concerns about a consumer’s needs in one period to considering those needs over multiple periods (Farrell & Klemperer 2006).

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Switching costs may be categorised in various ways, but Matthews (2009a) found that the nine basic categories of monetary loss, benefit loss, search, learning, brand relationship, personal relationship, service disruption, uncertainty, and hassle (see Table 1), were appropriate, and could be reduced to financial, relational and procedural. It was found that perceptions of these costs varied in relation to the family life cycle, and switching costs caused customers to be locked-in to their bank, as their desire to switch did not translate to a likelihood of actually changing banks.

It is possible that the nature of the banking relationship may also influence attitudes and behaviour around switching, due to its link to the family life cycle. This link can be illustrated by examining how a person’s banking relationship may change as they move through different stages in the family life cycle. For example, a young, single person living at home requires limited banking products and services, perhaps comprising a transaction account, a savings account and a debit card. Once they move out of home, automatic payments and/or direct debits may be needed to meet rent and other living expenses. The next ‘traditional’ move is to become part of a couple, followed by the addition of children to the family unit, with each stage adding more bank accounts and other products that could include home loans, credit cards, internet banking and additional regular payments. As the children grow up they leave home, and the family unit reduces back to a
couple, with retirement following and then a sole survivor, with this process likely seeing a related reduction in the banking relationship, with fewer accounts needed and the home loan fully repaid. Matthews (2009a) confirmed the existence of a relationship between the three elements of switching costs, family life cycle and banking relationship complexity, with the latter measured in two ways: by the total number of products held; and by the number of different types of product held.

This paper explores the influence of the nature of the banking relationship further, looking specifically at how the type and number of products held by a consumer affects their attitudes towards switching costs and switching. It may provide a number of lessons for Australia as it seeks to address concerns about switching costs in its banking market.

Data and methodology

This paper uses data collected for a recently completed broad study of switching costs in New Zealand. The data collection was undertaken in 2006, using a mailed questionnaire. The questionnaire was mailed out to 2,983 people across New Zealand, with the names drawn randomly from the election rolls. The initial posting was followed two weeks later with a reminder letter to non-respondents, and after a further two weeks, a second copy of the questionnaire was sent to continued non-respondents. A total of 955 valid responses were received, with 135 returned for an incorrect address and 130 people advising that they did not wish to participate in the study, giving a final response rate of 33.5 per cent.

The respondents are broadly representative of the New Zealand population. As often happens with surveys (Hair, Bush & Ortinau 2006) there is a higher proportion of female respondents (51.2 per cent) than found in the overall population. While the respondents are older, on average, than the New Zealand population, there is a reasonable distribution across the age groups. The respondent group appears to have a higher level of education, with 24.8 per cent holding a Bachelor degree or higher compared to 14.2 per cent in the New Zealand population, but this is also not unusual for survey respondents (Green 1996).

Respondents reported relationships with all the main bank brands and a number of smaller non-bank financial institutions, in proportions similar to the market shares of those financial institutions. More than half of respondents reported having a relationship with more than one financial institution, with 34.1 per cent having a relationship with two financial institutions, 13.4 per cent banking with three financial institutions, and 4.4 per cent banking with four to 11 financial institutions. As noted earlier, switching refers to the transfer of the main banking relationship, and these respondents answered the questions with respect to their main banking relationship.

The survey questionnaire comprised 70 questions, but not all are relevant for the issues discussed here. The variables of relevance here are: perceptions of switching costs; desire to switch banks; future likelihood of switching banks; and, the type and number of bank products held. Perceptions of switching costs are measured with 36 statements to which respondents were asked to indicate the extent of their agreement or disagreement using a seven-point Likert scale; 3–5 statements were associated with each of the nine categories of switching costs. Desire and likelihood of switching were each measured with two statements, which required a response on a 5–7 point Likert scale. Information about the bank products held by respondents was obtained with a question listing 12 different types of products, including deposit, loan and payment products, with respondents asked to indicate how many of each they held.

Perception of switching costs

The first question is how the number of products held influences perceptions of switching costs. Perceptions of switching costs varied according to the number of products held as previously reported in Matthews (2009b) and, as expected, on average, switching costs were perceived to be higher where more products were held. However, an exception was found in the case of the personal relationship category, where holding a greater number of bank products was associated with a perception of lower switching costs. There was no obvious explanation for this surprising result. The total number of products held was more important than the number of product types held (Matthews 2009b).

The other set of questions relates to the specific products held, and the influence that might have on a person’s attitudes towards switching costs and switching, because there is a perception that some products are easier to switch than others and some create a stronger tie to the existing provider.

Only holding a transaction account (p=0.01), a debit/EFTPOS card (p=0.03) and having internet banking (p=0.01) were significantly related to differences in perceptions (relative to not having that product) of switching costs overall. However, almost all of the products were associated with a variance in perceptions of some specific categories of switching costs as shown in Table 1. The only exception was savings account, which is therefore omitted from the table.

A variance in the perception of hassle was significantly related to seven different products and, in all cases, respondents holding that product perceive hassle to be greater than those who do not. Of particular interest is the fact that for all of the three regular payment products (automatic payments, direct debits and direct credits), respondents who have that payment perceive hassle to be greater than those who do not. A variance in the perception of monetary loss was significantly related to six different products, but the results for monetary loss are mixed. While monetary loss is perceived to be greater by those who have at least one housing loan, insurance
product, automatic payment or connected account, it is perceived to be lower by those who have internet banking or at least one transaction account.

Internet banking was the product type with the most significant variances in the perception of switching costs. Respondents with this service had significantly lower perceptions of switching costs in the categories of benefit loss, monetary loss, brand relationship and personal relationship, but perceived hassle as being higher.

Connected accounts were significantly related to the perception of higher switching costs for four categories: search, learning, monetary loss and hassle.

**Desire to switch and likelihood of switching**

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Matthews, Moore & Wright (2008) found that seven of the nine categories of switching costs reduce the likelihood of switching compared to the desire to do so — the exceptions were learning and uncertainty. This means that although the product type does not directly impact the likelihood of switching, it has an indirect effect through influencing perceptions of switching costs, which then reduce the likelihood of switching.

**Conclusion and lessons for Australia**

Understanding how the bank products that a customer holds influences their attitudes to switching allows for more accurately targeted action to be taken to address the specific issues associated with particular products. To some extent, the reported findings simply confirm existing perceptions about the effect of specific products. In doing so, the findings provide evidence that those perceptions are accurate, and they can inform policy action taken to deal with undesirable effects of switching costs.

A key finding of this paper is that customers holding more products perceive switching costs to be higher, but this
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does not influence their desire to switch or the likelihood of doing so. It would be difficult to deal with issues related to the number of products a person holds because this represents a decision reflecting the personal needs of individual customers, and this suggests that there would be limited value in addressing these issues.

The more important finding is that there is a difference in how specific bank products affect consumers’ attitudes towards switching. A key issue for consumers in thinking about switching is the perceived hassle in doing so, and the findings of this paper indicate that some bank products increase the perception of hassle, particularly the three forms of electronic payments (automatic payments, direct debits and direct credits). This suggests that finding ways to make it easier to deal with these electronic payments would assist in encouraging customers to switch. Internet banking, on the other hand, is something of a two-edged sword, as it reduces perceptions of several types of switching costs, but increases the perceived hassle of switching. It is possible that the increased hassle relates to the records of payees loaded that would need to be reloaded at a new bank, which is similar to the issues around the transfer of electronic payments.

Based on these findings, the actions taken to date in Australia to improve competitiveness in the banking market and to encourage customers to switch are unlikely to have any real effect. The focus to date has been on lending products, but these results indicate that these do not significantly affect perceptions of switching costs, although the reforms do address the perception of increased monetary loss for those with a housing loan.

As shown in this paper, there is a higher perception of switching costs for changing automatic payments and other electronic payments from an account at one bank to an account at another. Account number portability is proposed as one solution to reduce this switching cost and Matthews (2010) concludes that account number portability is the best solution for making it easier for customers to switch banks from a regulatory perspective.

Account number portability was one option considered in the government-commissioned report on greater account transferability. It was expected that the costs associated with this solution would be high, with recent comments from Westpac’s Chief Information Officer describing the costs of account number portability as ‘horrific’ and warning that from overseas experience it was unlikely that sufficient value would be delivered to justify the investment (Head 2011). The Dutch considered account number portability but deemed it too expensive and instead successfully introduced an automated system for dealing with the transfer of regular payments (direct debits etc). The high cost was confirmed by the Banking Services report, which found that account number portability would not deliver sufficient benefits to offset the substantial costs it would impose on payment system users (Fraser 2011).

The results of this paper indicate that the key to encouraging switching is to simplify the process of moving existing electronic payment arrangements between financial institutions. Thus, if the costs of account number portability are found to be excessive, another means that achieves the same effect would need to be found.
Notes
1. A more detailed description of the data and methodology used can be found in (Matthews 2009a).
2. While the survey was completed nearly five years ago, there have been no changes in the banking market that would be expected to substantially alter the findings.
3. The Likert scale is commonly used in survey research and asks respondents to select a response from an ordered list (generally five or seven items) ranging from, for example, completely disagree to completely agree.
4. These ‘p values’, and those in Table 1 refer to the probability of observing a difference of the size found between the two variables (product use and perception of switching cost type) by chance (under the null hypothesis that there is no difference).

References