



Massey University

Centre for Banking Studies



Te Kunenga
ki Pūrehuroa

Switching Costs in Banking: The Regulatory Response

Claire Matthews
Massey University



Background

- Switching costs are the factors that dissuade customers from changing banks
- Switching costs are an issue in banking markets around the world
- Banks have recognised switching costs are an issue
 - Seek to make switching as easy as possible



Background

- Banks are ambivalent about switching costs
 - Dissuades customers from switching **to** them, but also **away from** them
- Implications for competition
 - Ø An issue for regulators
 - But do regulators recognise this issue?



Prior Research

- Switching costs impact on markets
 - Allocative inefficiency (Klemperer, 1987)
 - Shifts basis of competition (Farrell & Klemperer, 2006)
 - Monopolistic profits (Ongena & Smith, 1997)



Prior Research

- Switching costs may require regulatory intervention
 - Krafft&Salies (2008), Carlsson&Löfgren (2004), Cruickshank (2000), Bakos (1997)
- Or not
 - Haucap (2003), Wilson &Waddams Price (2005)



Methodology & Data

- Postal survey
 - 955 people (33.5% response rate)
- Focus groups
 - 3 groups of 4 or 5 participants
- Interviews with bank staff
 - Representatives of 8 principal retail bank brands



Results

- Switching costs are present in the NZ banking market
 - *Hassle* is perceived to be the greatest
- Switching costs have some effect in dissuading customers from switching when they would like to do so
 - Applies for 7 of the 9 categories of switching costs used in the study



Recommendation 1

Regulatory authorities need to acknowledge the existence of switching costs, both financial and non-financial, in the banking market. The full range of switching costs and their effects should be taken into account in any consideration of competition issues in financial services.



Recommendation 2

In future decisions on mergers and acquisitions in the New Zealand banking market, the impact of switching costs in deterring customers from switching banks should be acknowledged and taken into account



Recommendation 3

*Regulators should **not** seek to legislate comparative disclosure requirements in respect of bank providers and services, leaving this for the market to address.*



Recommendation 4

- *Regulators should investigate the implementation of number portability, including an assessment of establishment and operational costs*



Conclusions

- Switching costs exist and dissuade customers from changing banks
- Regulators have done little to date
- There is an opportunity for regulators to be more proactive
 - Especially in dealing with the hassle of switching