Chapter 1
Summary . . .

# Changing Customer Needs

## Overview

- Changing customer needs are contributing to a reshaping of the financial services landscape. Changes in demographics and work force patterns are altering customers' financial needs. These factors, together with other changing customer attributes, affect distribution channels, products and suppliers.

## Key Findings

- Changing demographics are having a profound effect on customer needs. The Australian population is ageing, implying that there will be fewer people of working age to support a growing population of dependants.
- Changing work force patterns are also influencing customer needs. Those in employment have an increased need for convenience. At the same time, increased time spent in education, lower job security, continuing high unemployment and early retirement, imply many consumers are experiencing longer periods of low income relative to expenditure.
- Financial assets and liabilities of the household sector are increasing, implying that households now have greater exposure to the financial system than in the past.
- Customers are becoming more value conscious and are increasingly willing to adopt new technology.

- These changing customer needs have implications for distribution channels, product and supplier choice.
  - Customers are increasingly moving towards electronic channels of delivery which offer lower cost and greater convenience.
  - Products which offer increased convenience and desired features such as the ability to smooth cash flows over the life cycle, will increasingly be sought by consumers.
  - Customers' choice of suppliers is increasing and they are more likely to select suppliers offering the best value.

# Changing Customer Needs

## 1.1 Introduction

The Inquiry recognises customer needs as one of several powerful forces for change in the demand for, and delivery of, financial services. The key developments causing customer needs to change include:

- changing demographics;
- changing work patterns;
- increasing financial assets and liabilities of households;
- increasing awareness of value; and
- willingness to adopt technology.

Section 1.2 reviews developments in each of these areas. Section 1.3 considers their implications for transaction channel, product and supplier choice.

## 1.2 Developments Influencing Customer Needs

### 1.2.1 Changing Demographics

The ageing of the population is characteristic of Australia as well as other developed countries (see Figure 1.1). In particular, this reflects falling fertility rates and the large number of baby boomers' (people born from the mid-1940s to the 1960s). The Australian Bureau of Statistics (ABS) projects that by the year 2021 approximately 17.5 per cent of the Australian population will be over the age of 65, compared with 11.9 per cent in 1995 and 8.3 per cent in 1970.

## *Ageing of the Australian Population . . .*

Figure 1.1: Age Distribution (as per cent of total population)

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Source: ABS 1996, Cat. no. 3222.0 and ABS 1970 data provided to the Inquiry.

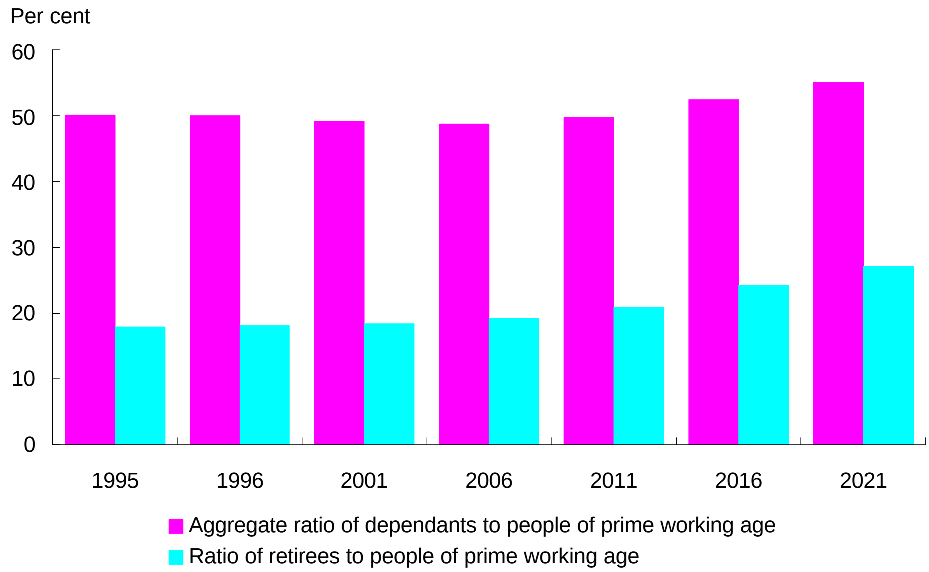
The dependency ratio broadly measures the extent to which people who do not work (those aged under 15 years and those 65 years and over) are supported by people of prime working age (15 to 64 years). This ratio is projected by the ABS to remain constant for the next 15 years and then to increase sharply after 2011, reaching 55.1 per cent in 2021 (Figure 1.2).[1]

On these projections, the aged will form an ever larger proportion of those who are dependent. By the year 2021, approximately 3.7 people of prime working age will be supporting each retiree, compared with approximately 5.3 people of prime working age for each retiree in 1995. This reflects the projected decline in the proportion of the population of prime working age from 2011 onwards as the baby boom generation begins to leave this age group. It also reflects increased life expectancy, which for both females and males is projected to be an average of three years longer in 2021 than it was in 1995. By 2021, females will be expected to live for an average of 83.9 years and males for 78.7 years.

## *Increasingly Dependent Population . . .*

1 ABS 1996, Cat. no. 3222.0. Note that the ratio of dependants to those in paid employment would be even higher. The prime working age category includes those unemployed and those not participating in the labour force.

Figure 1.2: Projected Ratio of Dependants to Working Age Population in Australia




Source: ABS 1996, Cat. no. 3222.0.

In view of these developments, governments have sought, through superannuation initiatives, to encourage reduced dependence by retirees on the age pension. This has led to a shift in household financial assets into market linked investments, meaning that households are directly bearing a greater proportion of investment risk than in the past (see Chapter 3). This trend is likely to continue as the population ages. If households adjust their financial behaviour in anticipation of their future needs, the implications of the ageing population for the financial system may be felt even earlier than the point at which the dependency ratio increases. These developments raise the importance to households of large accumulations of financial assets held in superannuation and other managed investments and the associated risk-return profile of these assets. Continued improvements in the cost effectiveness and reliability of advisory services (see Chapter 7) and in the efficiency of funds management will be required. Consequential changes in the focus of financial regulation are discussed in more detail in Chapter 8.

## 1.2.2 Changing Work Patterns

The number of people working extended hours is continuing to increase. The proportion of people in employment working more than 49 hours per week increased from 14.9 per cent in 1986 to 19.8 per cent in 1996.[2] An implication of this trend is that many people may now have less leisure time and therefore less time to spend on activities such as managing their financial affairs. This phenomenon also increases the value placed on service convenience.

The level of educational attainment of the labour force has increased steadily (see Figure 1.3). In 1996, 47.5 per cent of the labour force had some form of tertiary qualification, compared with 43 per cent in 1986. In addition, 30.6 per cent of the labour force had not completed secondary school in 1996, compared with 41.8 per cent in 1986.[3]

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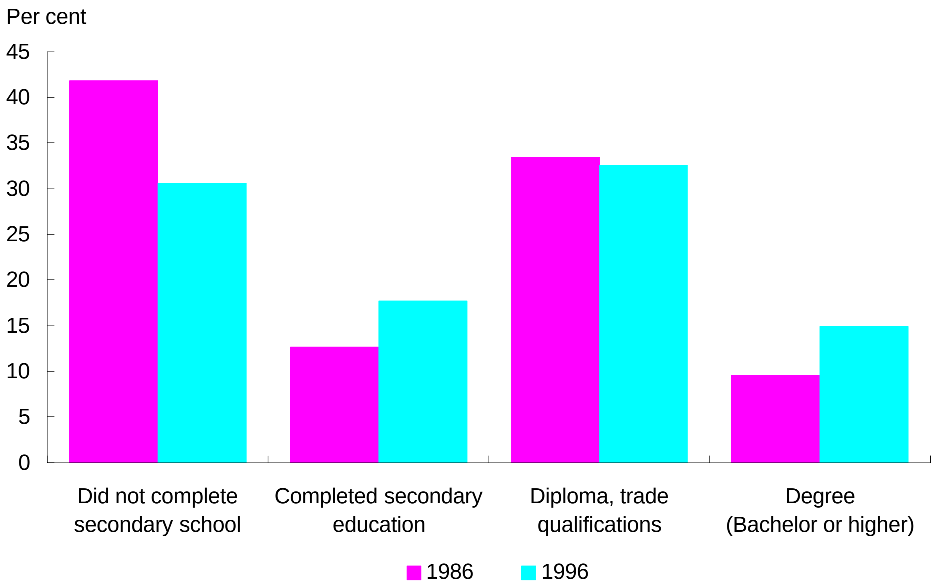
2 ABS 1996, Cat. no. 6203.0 (excludes unpaid family carers).
3 ABS 1994, Cat. no. 6235.0 and ABS 1996, Cat. no. 6227.0.

## *Higher Educational Levels of Australian Workers . . .*

Figure 1.3: Highest Level of Educational Attainment of Australian Labour Force




Note: Data for 1986 are as at February and 1996 data are as at May.
Source: ABS 1994, Cat. no. 6235.0 and ABS 1996, Cat. no. 6227.0.

There has also been a trend over the past 30 years towards early retirement, as evidenced by the decline in full-time labour force participation among those aged 55 or older. Between 1966 and 1996, participation of people older than 55 years in the full-time labour force declined from 33.2 per cent to 22.2 per cent. The majority of this decline was due to falling male participation in the labour force. The largest fall occurred in the 60 to 64 age group which experienced a 34.4 percentage point reduction between 1966 and 1996. [4]

As a result of increased time spent in education and earlier retirement, people are experiencing longer periods of low income relative to

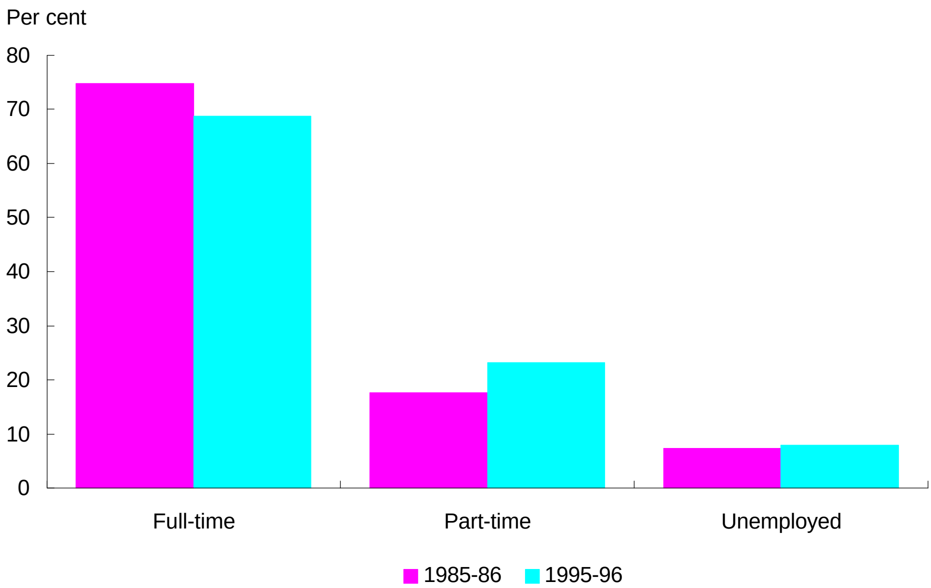
4 ABS 1996, Cat. no. 6203.0, October, p. 1.

expenditure. This increases the need for financial services which facilitate the smoothing of cash flows over an individual's life cycle.

The number of people in part-time employment is rising, currently accounting for 25 per cent of total employment (see Figure 1.4). Lower job security is generally associated with this type of employment, as it is with self-employment. The number of self-employed and those in unpaid family work was approximately 11 per cent of total employment in 1996.[5] Job mobility is also rising, with the proportion of the working population changing employers/businesses in a year increasing from 13 per cent in 1986 to 21 per cent in 1996.[6]

## *More Part-time Workers . . .*

Figure 1.4: Employment Status of Australian Labour Force




Source: ABS 1996, Cat. no. 6202.0.

5 ABS 1996, Cat. no. 6203.0.
6 ABS 1996, Cat. no. 6209.0

In summary, there are a number of distinct demographic and labour force trends that will affect the pattern of demand for financial services.

- Those in employment will generally have less time and will therefore have a greater need for products which offer convenience and ease of access.
- At the same time, many consumers will experience greater variability in the timing of income. Those consumers spending longer periods in education, those in part-time employment, the unemployed and those who accept early retirement, will generate a greater need for financial products which smooth cash flows over their life cycles. These products include student loans, home loans with variable repayment and redraw options, and home equity draw-down options for the elderly. Moreover, complexity resulting from uncertainty in the size and timing of future cash flows will remain a consistent feature in the management of financial arrangements.

### 1.2.3 Increasing Financial Assets and Liabilities of Households

Over the period 1989 to 1996, financial assets of the household sector grew at an average rate of 7.7 per cent per annum, totalling $640.5 billion in 1995-96.[7] Although bank deposits and life and superannuation fund investments represent the bulk of this amount, the former have fallen as a proportion of total household assets while the latter have increased.

Rising private sector indebtedness has accompanied the increase in household sector financial assets. Since 1989, total household sector liabilities

7 RBA 1996, *Reserve Bank of Australia Bulletin*, various editions 1989-96. Comparable data are not available prior to 1988-89. The household sector is defined as households plus unincorporated enterprises. The sector's financial assets are defined to include notes and coin, deposits, superannuation, life insurance, Commonwealth Government securities, equities, units in trusts, and other financial assets.

grew at an average of 9 per cent per annum to reach $290.3 billion in 1996. Loans from banks represented almost three-quarters of this amount.[8]

As a consequence of these trends, Australian households now rely more on the financial system and have greater exposures to particular financial service providers and to the financial system generally. This trend heightens the importance of the overall efficiency and safety of the financial system. A further important implication is that, with greater financial wealth, households will tend to shift their preferences towards the higher end of the risk-return spectrum, with a consequent shift towards managed funds and holdings of market linked investments and away from holdings of deposits and other low-risk products.

### 1.2.4 Increasing Value Awareness

As they have in the past, consumers will seek out those financial products and suppliers which offer the best value for money.

Several factors will heighten consumer awareness of product and supplier value in the future. This increased awareness will operate as a powerful competitive force for change in the finance sector.

The greater range of financial products and suppliers now available in the financial sector is accompanied by a wider range of sources of information (although, in some cases, there are problems regarding the quality of this information — see Chapter 15). Specialist financial information providers, financial magazines, television programs and financial features in the daily newspapers already provide a variety of comparative information. The Internet is also an example of an emerging tool for financial product comparisons. Scanning devices called ‘intelligent agents’ can search public networks (such as the Internet) quickly and cheaply to find financial products which best meet the specific needs of individuals. These developments are increasing consumer awareness of the range of products and suppliers available.

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8 RBA 1996, *Reserve Bank of Australia Bulletin*, various editions 1989-1996.

In addition, the move by deposit taking institutions towards more explicit pricing of transaction services has increased customer value awareness. Customers are increasingly paying transaction fees which more closely reflect the underlying cost of providing the services, and are likely to alter their transaction behaviour accordingly by switching to cheaper, electronic methods of transacting.

Consumers are becoming more price sensitive to transaction fees as well as to interest rates on more expensive financial products such as loans (see Chapter 10). A 1996 Australian Chamber of Commerce and Industry member survey indicated that during the previous three years 59.3 per cent of respondents had searched actively for a different financial institution to service their lending needs.[9] Further evidence of the increased value awareness of consumers is provided by trends in the home loan market. The widening range of housing loan products available has encouraged borrowers to shop around and to switch lenders. In the twelve months to October 1996, 23 per cent of home loans were refinancing loans, compared with 8 per cent in the twelve months to June 1992.[10]

The large number of products available, with varying characteristics, is evidence of the extent to which a broad range of consumer needs can be met. For example, in 1996, customers could choose from approximately 1,760 different mortgage products and over 1,800 deposit accounts with varying (in some cases, fairly minor) characteristics (see Chapter 15).[11]

### 1.2.5 Willingness to Adopt Technology

Customer take-up, or acceptance, of new technologies is another key driver determining the rate of change in the financial sector. For the majority of consumers to use new technologies, the following conditions must hold.

- The technologies must:
  - be reasonably priced relative to alternatives;

9 Australian Chamber of Commerce and Industry, Supplementary Submission No. 121.
10 ABS 1996, Cat. no. 5609.0. Refinancing data are available from July 1991 onwards only.
11 Data provided to the Inquiry by Cannex (Aust).

  - — be easy to use; and
  - — fulfil a specific need.
- ➢ Consumers must be educated in their use.

Some 'technologically oriented' consumers will readily take up new technologies without all of these conditions being met, while others will be less inclined to use such technologies.

There is evidence in Australia of increasing use of new financial services technologies by consumers. One factor driving more rapid take-up is familiarity with new technologies gained in the workplace — for some technologies, the workplace is an important point of access for financial system customers. The Inquiry expects the shift towards electronic means of conducting financial activity to continue, as new technologies fall in price and become more user friendly. This is discussed in Chapter 2.

The method of delivering financial services is clearly linked to consumers' preferences in other industries. For example:

- ➢ the emergence of supermarket 'kiosk' branches is related to a perceived desire of consumers to shop outside traditional trading hours — the kiosk allows consumers to combine shopping and banking;
- ➢ the facility allowing the use of Australian credit cards in thousands of ATMs worldwide reflects the increasing mobility of the population; and
- ➢ Internet and telephone banking reflect some customers' increasing use of technology in the home for a wide range of applications.

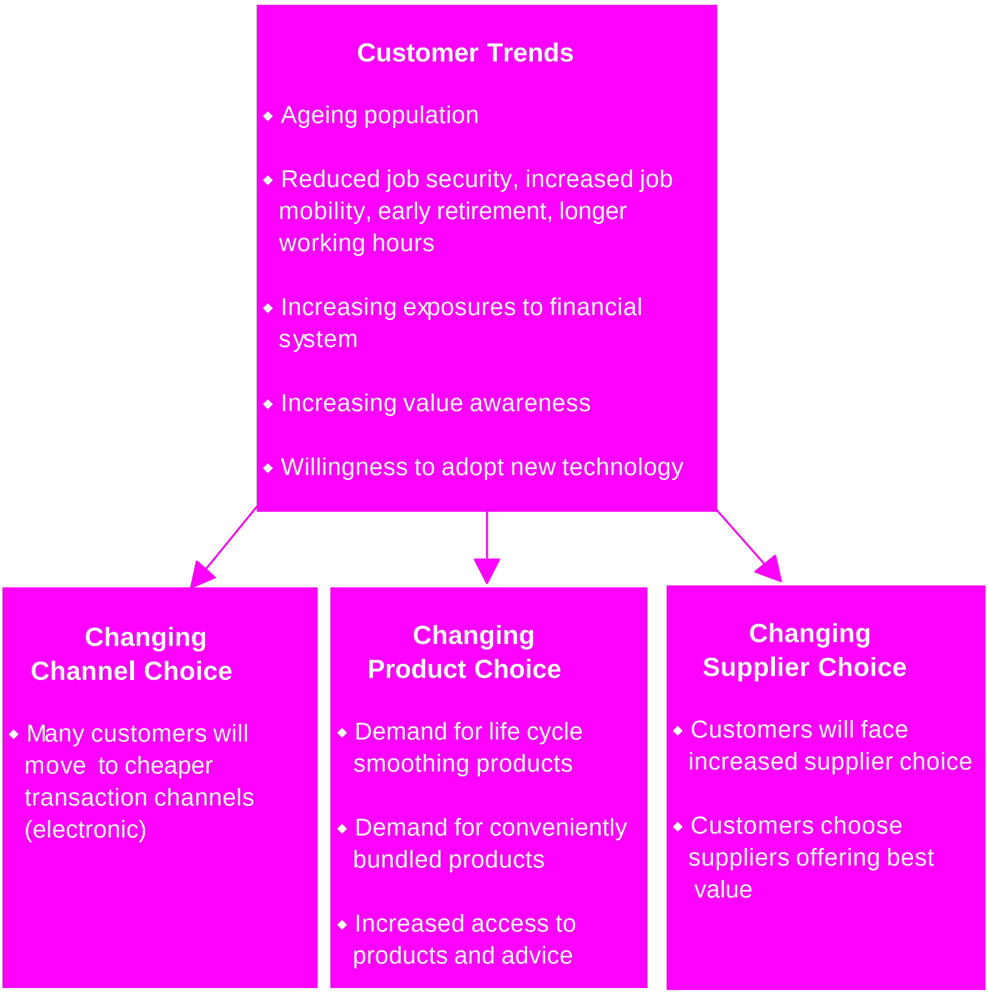
As community preferences change in areas outside financial services, methods of delivering financial services will also change in response to these external linkages.

## 1.3 Implications for Distribution Channel, Product and Supplier Choice

The implications of the customer trends identified above are summarised in Figure 1.5.

***Changing Customer Trends are Driving Channel, Product and Supplier Choice . . .***

Figure 1.5: Implications of Customer Trends



The needs of consumers for financial products and services clearly depend on their stage in life. Early and late stages of the life cycle may be characterised by low income relative to expenses, while mid-cycle stages are characterised by high income relative to expenses.

Thus, as the population continues to age, the need for retirement, wealth management and transfer products will increase. The value of assets invested in superannuation funds is projected to increase substantially, reaching between $1,494 billion and $1,825 billion in 2020.[12] The flow of funds from inheritances and cross-generational transfers of wealth is also likely to continue to rise. In the US, it is estimated that cumulative cross-generational bequests will increase from US$336 billion in 1995 to US$3,203 billion by 2010.[13] Among other things, these factors will continue to promote the shift in household saving away from traditional deposit products towards managed funds as preferred investment vehicles for these flows.

In addition, customers will increasingly need financial products which enable them more effectively to smooth spending over their lifetimes, in the face of decreasing job security, increasing job mobility and increasing time spent in educational institutions. Accelerated repayment and redraw facilities on loans are examples of such products.

It may be that government and the financial system will need to take further initiatives to provide the necessary means for consumers to smooth spending power over their life cycles. Possible initiatives could include facilitating access to funds for retirees, secured by their illiquid assets such as housing.

Because of the trend towards longer working hours, customers may demand financial product packages as the most convenient and least time consuming means of conducting financial activities. In view of the likely increase in product range and complexity, consumers may increasingly rely on brand

12 Projections of the Retirement Income Modelling Task Force, 1997 — data supplied to the Inquiry. Variations in the projected amount depend upon whether or not government supported co-contributions are introduced. Readers are referred to Chapter 3 for a more detailed discussion.

13 Coopers & Lybrand 1996.

names, information assimilating technology and financial advisers in designing their product packages. However, because of the increasing value awareness of consumers, such product packages will be attractive only if they are priced competitively.

Alternatively, for some customers, greater access to, and choice of, financial products and advice will mean that they will increasingly be able to identify those products and product packages which represent the best value for money. This will also apply to their choice of supplier. Market share will be gained and held by those suppliers whose products represent the best value proposition for consumers. As a result, inefficiencies will become increasingly unsustainable in financial markets.

## 1.4 Conclusion

Changing customer needs represent an important driver of change in the finance industry. The combination of changing demographics and work patterns are altering the features that customers will seek from financial products. Their increasing willingness to adopt new technology will shape the way in which those services are delivered, while greater focus on value will mean that only those suppliers will prosper who offer products with desired features and at an attractive price.

The increasing holdings of financial assets and liabilities by households mean that consumers now have greater exposure to the financial system than in the past.

Success in the future will flow to those organisations which are able to sense these changing customer needs and which can meet their customers' price, service and delivery expectations.