Chapter 15
Summary . . .

Stocktake: The Financial System

Overview

- In making its recommendations, the Campbell Committee was motivated by a firm belief that less intrusive regulation and greater competition would lead to greater efficiency in the financial system. In turn, economy wide benefits from greater competition and efficiency would be realised through enhanced financial system competitiveness. Most importantly, consumers would benefit from improved choice and quality in financial services. This chapter assesses the effectiveness of deregulation in achieving these objectives.

Key Findings

- An assessment of the consequences of deregulation must be considered in the context of two factors. First, deregulation did not occur in a policy vacuum — it is not possible to isolate the role of financial deregulation from the range of other developments over the 1980s and 1990s which contributed to changes in the financial system. Secondly, the hard data required to assess the consequences of deregulation are, in many cases, lacking. Therefore, the analysis often relies, of necessity, on more qualitative and impressionistic observation.
- On balance, the increase in competition which was expected to flow from deregulation, particularly in the retail deposit taking sector, has been slow to arise. Only in more recent times have some retail financial markets (eg home mortgages) become obviously more competitive.

- Efficiency has improved in several areas since deregulation. Increased pricing efficiency in securities and foreign exchange markets in particular, has improved resource allocation. The productivity of finance sector participants has risen in many cases, as has their dynamic efficiency, with technological innovation playing a major role in these improvements.
- International competitiveness was not a major focus of the Campbell Inquiry. The limited data available provide some support for the view that underlying competitiveness has increased since deregulation in some areas of the financial system but deteriorated in others.
- Product choice has widened since the early 1980s. This is attributable to deregulation, as well as to technological developments, government superannuation initiatives and the increasing integration of international financial markets. The quality of financial products has also risen.
- However, one exception to the improvement of financial products and services is the provision of information and advice, which still appears to be in need of further development.
- Although deregulation has yielded benefits in the above areas, there is room for further improvement.

Stocktake: The Financial System

15.1 Introduction

Chapter 14 reviewed in detail the process of financial deregulation initiated by the Campbell Inquiry. This chapter deals with the consequences of deregulation for the financial system. The impact of deregulation on the regulatory framework and on the wider economy are analysed in Chapters 16 and 17, respectively.

In this chapter, the extent of benefits arising from deregulation are examined under the following headings.

- **Competition in the financial system.** Motivating the Campbell Committee was a firm belief that less intrusive regulation and greater competition would lead to greater efficiency. Accordingly, the Campbell Committee recommendations reflected a confidence in market forces and the discipline of competition.
- **Efficiency of the financial system.** In announcing the establishment of the Campbell Inquiry in January 1979, the Treasurer stated that the Inquiry 'should be seen as a positive attempt by the Government to improve the efficiency and flexibility of the Australian financial system'.[1]
- **International competitiveness of Australia's financial system.** In recent years, increasing attention has been paid to the international competitiveness of the Australian financial system. While this was not a major focus of the Campbell Inquiry, the concern expressed by many over the low level of national savings and the associated increase in overseas borrowing has increased focus on the

1 Australian Financial System Inquiry (Campbell Committee) 1981, p. xxvii.

international competitiveness of various industries, including the finance sector.

- **Choice and quality of financial products.** Most of all, benefits of deregulation were expected to be visible in the outputs of the financial system. When banks and other financial institutions were heavily regulated, they offered a narrow range of basic financial products and services. In part, regulations prevented them from developing a more extensive range of services, but there was also little incentive for them to develop new products in the absence of effective competition.

In the decade following release of the Campbell Report, successive Australian governments implemented virtually all of its recommendations (see Table 14.3). On the surface therefore, evaluation of the effectiveness of deregulation in increasing competition, efficiency and international competitiveness, as well as product choice and quality, should be straightforward. In practice, it is very difficult. To begin with, available measures of these variables are far from reliable. Equally important, as noted in Chapter 14, the recommendations were not implemented in a policy vacuum. Many of the developments of the 1980s and 1990s would have occurred in any case, and for reasons totally unrelated to financial deregulation in Australia. Furthermore, it is not possible to isolate the separate role of financial deregulation in promoting these developments from that of other contributing factors.

Accordingly, the Inquiry is content to identify the changes since the early 1980s in competition, efficiency and international competitiveness, as well as in product choice and quality, while acknowledging that many influences, including financial deregulation and related developments both within and beyond financial markets, played a part in promoting these outcomes. Each of these factors is now examined in turn.

15.2 Competition in the Financial System

Competition describes the way in which current and potential suppliers of particular products interact with each other in meeting consumer demand.

In markets where the degree of competition among suppliers is high, prices are likely to reflect the underlying cost of production. Suppliers pricing above this cost will be undercut by other suppliers, thereby losing market share. Thus, the incentives facing suppliers to operate efficiently are greater, if the degree of competition in the market is higher.

The benefits to consumers, and to the economy more generally, of efficiency in supply are that consumers pay fair prices for products and the economy's scarce resources are allocated to their highest value uses, thus minimising waste. In making its recommendations, the Campbell Committee noted that 'in the long run, the community as a whole will be better off (ie the efficiency with which resources are allocated throughout the community will be improved) if financial markets are allowed to operate more freely and with less direct government intervention — subject to there being effective competition'.[2]

It has long been recognised that competition does not necessarily require the physical presence of many suppliers, but simply that suppliers be able to enter the market freely if existing suppliers do not price competitively. Such a market is said to be 'contestable'. In a highly contestable market, the barriers to market entry are sufficiently low for new players to enter quickly, undercut any incumbent suppliers who are not producing and pricing efficiently, gain market share and then exit just as quickly when desired. It is this threat of 'hit and run' entry which provides incumbents with the incentive to operate in the most efficient manner possible.

There appears to be a perception that, at least in some areas, financial markets have displayed greater levels of competition since deregulation. For example, the Australian Chamber of Commerce and Industry (ACCI) 1996 member survey revealed a majority view that the past decade has led to a far greater degree of competition in financial markets.[3] Moreover, the more distant the point of comparison, the greater the improvement is perceived to have been.

Changes in the level of competition within a market can be assessed in various ways, including examination of the number of participants, barriers

2 Australian Financial System Inquiry (Campbell Committee) 1981, p. 531.
3 Australian Chamber of Commerce and Industry, Supplementary Submission No. 121.

to entry and profitability. While none of these measures can be accepted without qualification, together they provide a starting point for comparing competition in various sectors of the Australian financial system since deregulation.

15.2.1 Market Structure and Entry Barriers

A market can be contestable, even with a small number of participants, provided barriers to entry and exit are low. Market concentration and barriers to entry are considered jointly here for three broadly defined market segments:

- deposit taking;
- life insurance, superannuation and other managed funds; and
- markets for business debt.

The Inquiry has also reported findings in relation to competition in these and other areas in Chapter 10.

Deposit Taking

Since the early 1980s, there has been a slight fall in the number of deposit taking institutions. Superficially, the smaller number of institutions since deregulation points to a reduction in competition. However, the slight decline in the number of players reflects primarily the substantial rationalisation which occurred after deregulation, as building societies converted to banks and banks re-absorbed their non-bank subsidiaries. Deregulation has also seen the removal of inefficient, duplicative structures created during the 1960s and 1970s to circumvent regulation. For example, some of the smaller, uncompetitive credit unions merged after deregulation.

In these respects, the total number of institutions before deregulation was not a good indicator of the number of independent, competitive units in the market.

This trend towards market rationalisation tends to mask the competitive impact of lowering barriers to entry into the deposit taking sector, particularly in banking, where the sector was perceived to be closed to new entrants prior to the 1980s. Following deregulation, competition in the banking sector received a boost from the introduction of foreign competition, first in the form of subsidiaries of foreign banks and, more recently, in the form of branches. While few foreign banks have made major inroads into the banking market, particularly in the retail sector, their inclusion served to make the market more contestable and prompted the Australian banks to consolidate through merger in anticipation of foreign competition.

A second source of competition has been the more ready availability of close substitute products. Examples include capital backed life company policies, which operate similarly to term deposits, and cash trusts and common funds. While the market penetration of these products has not been strong, and while their impact is restricted to particular market segments, they have provided an element of price competition in these segments.

Life Insurance, Superannuation and Other Managed Funds

Changes in market structure among life insurance companies, superannuation funds and other managed funds have been driven more by changes to taxation and retirement incomes policy than by deregulation. Nonetheless, the removal of restrictions on the commercial activities of banks as part of deregulation, resulting in subsidiaries of these institutions offering insurance and funds management products, served to make these markets more competitive. The abolition of exchange rate controls removed restrictions on portfolio investment overseas and shorter-term funds management. Some life companies took advantage of this to establish overseas subsidiaries to engage in international investment management. Also, the 30/20 rule which applied to life companies and superannuation funds, reducing their capacity to offer competitive services to their customers, was abolished in 1984 as part of the deregulatory process.

Comparisons of market structure and barriers to entry for life insurance, superannuation and other managed funds paint a mixed picture. Unlike the deposit taking sector, the number of suppliers of these products has increased substantially since deregulation, driven largely by government initiatives to promote investment in long-term saving/retirement products.

However, despite the proliferation of small funds, industry concentration has actually increased since deregulation.

The contestability of superannuation and funds management markets remains limited by a variety of factors. These are discussed in Chapter 11. However, none of these can be ascribed to the impact of deregulation.

Markets for Business Debt

The Campbell Committee noted that the debt market for medium to large corporate borrowers was highly competitive and innovative. The number of institutional participants at the time was large and entry was relatively free.[4] In addition, large businesses had the capacity to gain direct access to securities markets and thus were not dependent on institutional intermediaries. However, government regulation, such as the 30/20 rule and restrictions on small bank overdraft interest rates, often worked to the disadvantage of corporate borrowers in domestic markets.

The subsequent abolition of these restrictions lowered barriers to entry. The entry of foreign banks into the Australian financial system following deregulation also served to increase the number of corporate debt providers and arrangers and to intensify competition in the corporate debt market.

The Campbell Committee found the market for small business debt to be somewhat less competitive, in large part due to distortions created by government regulation. Only recently have new suppliers entered this market. A contributing factor has been the increase in competition in some other credit markets, notably that for mortgage finance (see Chapter 4), which has shifted some of the focus of banks to lending for small business. However, as in the deposit taking sector, these developments appear to have been slow in emerging.

4 Australian Financial System Inquiry (Campbell Committee) 1981, p. 529.

15.2.2 Profitability

The profitability of industry participants and the pricing of their products are sometimes used as an indicator of the underlying level of competition in a particular market.

Oster and Antioch argue that the increase in competition following deregulation should have contributed to the narrowing of the gap between bank profitability and the profitability of all companies.[5] Measuring profitability as the return on shareholder funds, they found that average bank profitability decreased from 15.6 per cent over 1980-84 to 6.7 per cent over 1990-94. Over the same period, the return on shareholder funds for all companies decreased from 9.9 per cent to 6.2 per cent.

The reduction in profitability, both in absolute terms and relative to all industries, cannot be attributed solely to deregulation. Bank profitability, as measured by the return on shareholder funds, generally exhibits a cyclical pattern. The historical points of comparison used in the above study involved different phases of the business cycle.

In addition, low returns on shareholder funds in the early 1990s owed more to losses incurred during the excesses of the 1980s than to intense competition. Further, returns on shareholder funds have increased strongly since the end point of the above study. In particular, the major banks have posted record profits over the past year.

Bank net interest margins are also used as an indicator of profitability and the underlying level of competition.[6] These margins are calculated as the difference between the average interest rates banks charge on their loans and the average rates they pay on their deposits. Evidence from the Reserve Bank of Australia (RBA) shows a slight downward trend in net interest margins, from 5 per cent in 1986 to 4.4 per cent in 1996, suggesting declining profitability and greater competition in the retail deposit taking sector.[7]

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5 Oster & Antioch 1996, p. 208.

6 Bank net interest margins do not exhibit the same degree of cyclical fluctuation as do returns on shareholder funds, largely because they do not reflect bad debts.

7 Data provided to the Inquiry by the RBA.

These margins have fallen sharply more recently, largely as a result of heightened competition in the home lending market. The pressure on bank margins has been amplified by falling barriers to entry facilitated by technological innovation which, among other things, provides players with alternative ways of accessing customers and distributing products. As a result, non-bank competitors, led by the mortgage originators, have entered traditionally bank dominated areas of intermediary finance.

Profitability has increased in the life insurance industry over the period 1985 to 1995, reflecting the near four-fold increase in total premium income and the increased focus on improving efficiency levels and reducing costs.[8] The life insurance industry has experienced substantial growth over this period, largely through increased emphasis on superannuation and market linked investment products. Consolidation has also occurred through mergers and acquisitions and the growth of life insurers owned by banks.

On balance, the increase in competition which was expected to flow from deregulation, particularly in the retail deposit taking sector, has been slow to arise. Only in more recent times have some retail financial markets become obviously more competitive.

15.3 Efficiency

In assessing the effects of improvements in competition since deregulation on financial system efficiency, three types of financial system efficiency are of interest:

- allocative efficiency: the extent to which resources available to the finance sector are being allocated to their highest value use (including across time);
- technical efficiency: the extent to which the output of the finance sector is being maximised for a given amount of productive inputs or, analogously, the extent to which average production costs are minimised in the long run; and

8 KPMG 1996, *Insurance Industry Survey*.

- dynamic efficiency: the extent to which the finance sector is engaging actively in product innovation and making use of the most cost-effective technologies as they become commercially available.

15.3.1 Allocative Efficiency

Fees and charges imposed by financial institutions will be allocatively efficient if they reflect the underlying cost of providing the service. This principle of 'user pays' is widely regarded as central to ensuring that the most efficient providers and types of services prevail in the market.

The benefits of improving allocative efficiency in the finance sector are not confined to finance sector participants. The finance sector is an important element of economic and corporate vitality in that it facilitates access by Australian businesses to markets, capital and information, both domestically and internationally. Thus, more efficient pricing has benefits for the whole economy. These macroeconomic benefits are examined in Chapter 17, while the benefits to finance sector participants are the focus of this section.

In view of the various pricing controls which applied prior to deregulation, it is not surprising that fees and charges in many instances have adjusted to align more closely with the user pays principle since deregulation.

Stockbroking Commissions

Prior to deregulation, the stockbroking industry was closely regulated with agreed scales of fees. Before 1984, the Australian Associated Stock Exchanges had secured authorisation for fixed commissions in equities trading by stockbrokers. Following hearings of the Trade Practices Commission, fixed commissions were abandoned, with brokerage being determined from April 1984 with individual clients. Evidence of the substantial decline in commissions since 1980 is presented in Table 15.1.

Stock Market Commissions have Fallen . . .

Table 15.1: Equity Market Commissions (per cent of trade value)

	1980	1995
Professional deal	0.7	0.2 - 0.4
Retail deal	2.6	1.0 - 2.0

Source: International Banks and Securities Association of Australia, Submission No. 146, p. 39.

Bid-Ask Spreads

Perhaps the best evidence of more efficient resource allocation and increased competition since deregulation comes from pricing in securities and foreign exchange markets (in which the financial institutions covered above are major players). An important aspect of market pricing is the bid-ask spreads. These measure the cost of transacting in markets.

Table 15.2 reports bid-ask spreads for selected fixed interest securities markets in 1980 and 1995. The data suggest that the cost of trading in these markets has declined substantially since deregulation, contributing to the observed growth in turnover. While deregulation was not the only factor at work, it facilitated the growth of secondary markets in fixed interest securities.

Debt Security Spreads have Fallen, Promoting Greater Turnover. . .

Table 15.2: Interest Rate Bid-Ask Spreads

		1980	1995
Government bonds:	Spread (basis points)	25	3
	Turnover (% of GDP)	9	325
Bank bills:	Spread (basis points)	10-15	3

	Turnover (% of GDP)	23	56

Source: International Banks and Securities Association of Australia, Submission No.146, p. 39.

Prior to the floating of the exchange rate in December 1983, bid-ask spreads on foreign exchange transactions for banks were guaranteed by the RBA. Also, foreign exchange transactions with corporate customers were mostly at set margins and were not quoted on a two-way basis. As shown in Table 15.3, interbank, corporate and retail market exchange rate spreads have all decreased substantially since deregulation, reflecting both the market determination of the exchange rate and increased allocative efficiency.

Exchange rate spreads narrowed in the late 1980s and early 1990s, as some banks began to quote on transactions of $20 million to $30 million on a reciprocal basis at agreed spreads ranging from 5 to 7 points. It was not uncommon in this period for some banks to offer negative spreads to selected corporate customers to attract new corporate business.[9]

Foreign Exchange Spreads have Fallen . . .

Table 15.3: Exchange Rate Bid-Ask Spreads[10]

	Pre-float spread	Early float spread (1984-88)	Current spread
Interbank market standard parcel	5 to 10 points	5 to 7 points	5 points
Corporate market standard parcel	5 to 10 points	5 points	2 to 3 points (or better)
Small retail (up to $50,000)	48 points	50 points	40 points

Source: Data provided to the Inquiry by the RBA, 1996.

9 Data provided to the Inquiry by the RBA.
10 Exchange rate points: 1 point = 0.0001 when say $1 = US$ 0.8000.

Fees and Charges on Retail Transaction Accounts

In the banking sector, prior to deregulation, interest rate and maturity controls resulted in a pricing structure under which most retail payments and transaction services were provided free of charge, with institutions offsetting this cost against lower interest rates on deposits. As a result of these controls, the banking system practiced considerable cross-subsidisation among different products and customer groups.

Only recently has the pricing of these banking services begun to reflect more closely the user pays principle, thus creating incentives for allocative efficiency improvements. For example, fees on retail transaction accounts (RTAs) were introduced by banks during the early 1990s. However, these fees are yet to cover fully the underlying cost of providing RTAs. The Prices Surveillance Authority (PSA) suggested in 1995 that financial institutions providing RTAs were recovering less than 15 per cent of the costs of providing RTAs through fees and charges (see also Chapter 4).[11]

15.3.2 Technical Efficiency

By increasing competition in the financial system, deregulation provided institutions with an incentive to reduce production costs, or to increase their technical efficiency.

Operating expenses are one, albeit imperfect, measure of technical efficiency and in many cases consolidated expense data covering the 1980s are not readily available. Those data which are available are presented in Figures 15.1 and 15.2 below.

Over the period 1987 to 1995, the ratios of operating expenses both to total assets and to operating income fell for the banks, pointing to a likely increase in technical efficiency. There are, of course, many factors that contribute to costs. In addition to competition, the reduction in the ratio of operating costs to assets for banks would have been helped by subdued wage inflation, strong asset growth and the sharp increase in the volume of

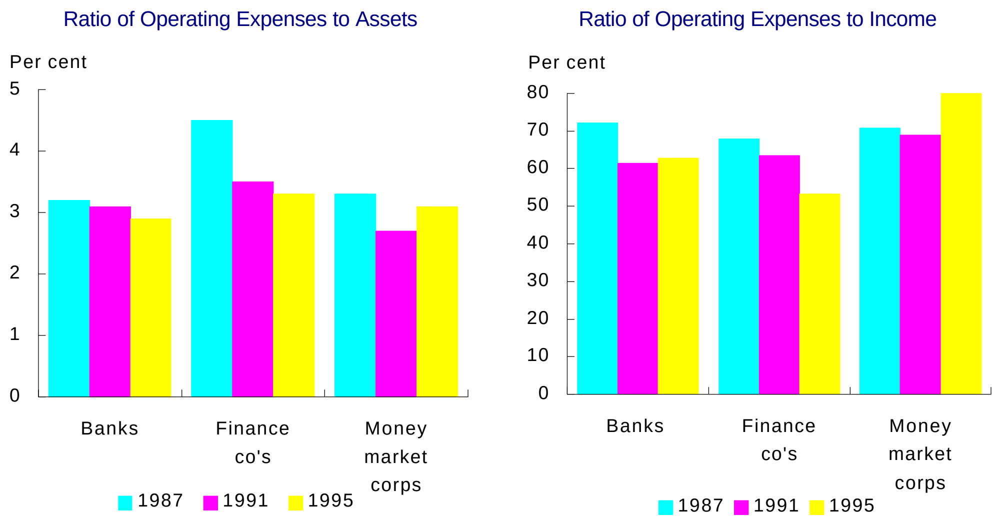
11 Prices Surveillance Authority 1995, p. xxi.

high-value, low margin business, particularly in international markets, over the 1980s.[12]

Finance companies experienced similar declines in operating expenses over the period 1987 to 1995. However, the evidence is less clear cut for money market corporations, with the ratio of expenses to assets declining slightly, and the ratio of expenses to operating income increasing between 1987 and 1995.

Possible Efficiency Improvements for Banks and Finance Companies . . .

15.1: Operating Expense Ratios of Banks and Finance Companies



Source: KPMG 1996, *Financial Institutions Performance Survey*, 1995 and 1996.

Operating expense ratios decreased for credit unions but increased for building societies over the period 1988 to 1995 (see Figure 15.2). The former result reflects the rationalisation of credit unions over this period, yielding scale economy benefits in many cases. The latter result reflects the exit of the

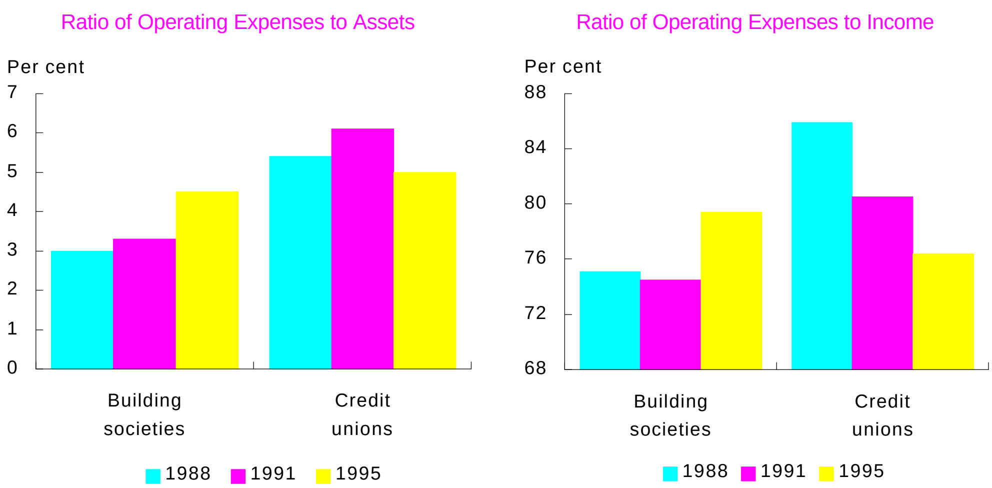
12 Phelps 1991.

largest, more efficient building societies from the KMPG survey, as they converted to banks (eg St George, Metway).[13]

In addition, the ratio of operating expenses to premium income for life companies decreased over the 1980s reflecting, among other things, the heightened competition in the supply of life products and improvements in technical efficiency. For the ordinary business of life companies, the ratio of operating expenses to premium income fell from 33.9 per cent in 1982 to 26 per cent in 1990. For superannuation business, this ratio fell from 18.9 per cent to 12 per cent over the same period.[14]

Possible Efficiency Improvements for Credit Unions . . .

15.2: Operating Expense Ratios of Building Societies and Credit Unions



Source: KPMG 1996, *Financial Institutions Performance Survey*, 1995 and 1996.

13 The KMPG survey covers the major building societies only. The conversion of the larger building societies to banks is likely to have left the smaller, less efficient institutions in the survey over time.

14 Lewis & Wallace (ed.) 1993. Chapter 6 has details on expense ratios for the whole-of-life business of life companies.

Treasury argues that there have been technical efficiency improvements in life insurance since deregulation.[15] Factors contributing to this improvement include a reduction in the ability of larger players to cross-subsidise due to the entry of niche players into the most profitable product markets and the price competition coming from competing investment products. Increased disclosure of fees and commissions and the trend towards unbundling of the risk and investment components of life insurance products have also contributed to improvements in technical efficiency.

A second measure of technical efficiency is productivity. If resources are being used more efficiently in the finance sector since deregulation, this should be reflected in productivity gains. Total factor productivity (TFP) is a widely used measure of the relationship between real output and the real resource inputs required to produce this output. [16]

Several difficulties emerge in calculating TFP for the finance sector. Calculations of TFP rely on a measure of sectoral output. The conventional measure of output in the finance sector produced by the Australian Bureau of Statistics (ABS) is not particularly helpful, in that it measures output as the gross operating surplus of financial enterprises plus the wages and salaries paid by these enterprises. Since labour costs are the major part of resource input costs, the ABS measure provides little distinction between the value of input and output.

An alternative measure of finance sector productivity can be derived by using finance sector assets as a proxy for output.[17] This is a broad proxy measure only, since it fails to capture changes in the relative importance of transaction and other services in the finance industry. In addition, assets are a stock concept, representing given amounts at a particular time, whereas output is a flow concept, expressed as an amount per unit of time. Nonetheless, it is likely to provide a better overall guide than the alternative ABS measure.

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15 Department of the Treasury, Submission No. 143.

16 TFP may be calculated as follows:

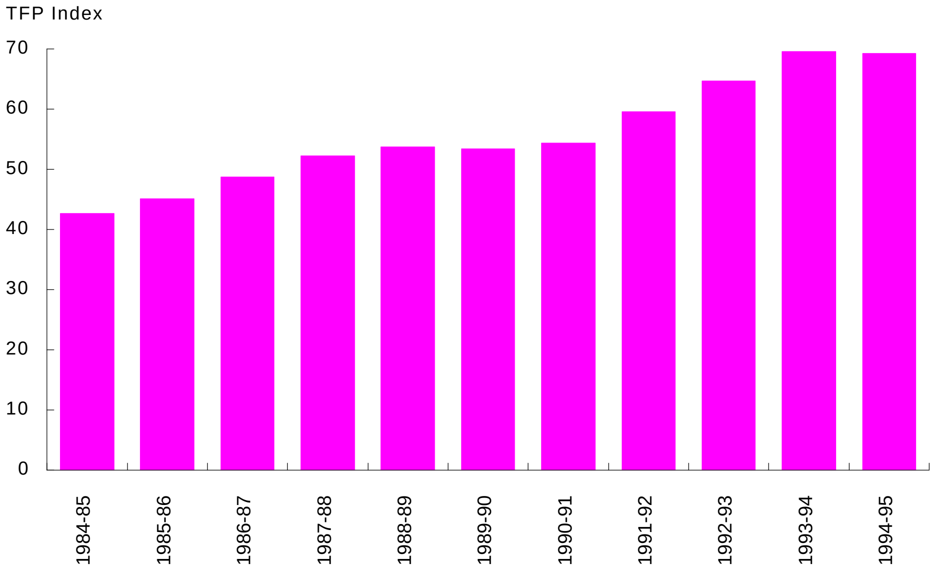
$$TFP \ for \ product \ A = \frac{Real \ value \ of \ one \ unit \ of \ A}{Sum \ of \ real \ value \ of \ inputs \ used \ to \ produce \ A}$$

17 See Colwell & Davis 1992 for discussion of this and other methods.

A measure of TFP for the finance sector, using this output proxy over the period for which data are available, is presented in Figure 15.3. The figure indicates that TFP has increased since deregulation. In 1984-85, one dollar's worth of productive inputs (labour and capital) produced $43 of finance sector output. In comparison, in 1994-95, one dollar's worth of productive inputs produced $69 of finance sector output.

Finance Sector Productivity has Increased . . .

Figure 15.3: Total Factor Productivity of Finance Sector



Source: ABS Cat. no. 5221.0, 6302.0 and 6203.0; RBA 1996, *Reserve Bank of Australia Bulletin*, various issues.

Again, many factors other than deregulation are likely to have affected finance sector productivity. In particular, technological innovation has reduced the cost of computer networks and telecommunications infrastructure substantially for all sectors of the Australian economy.

The wide range of microeconomic reform initiatives undertaken by government have also affected most sectors of the economy. Thus, productivity improvements have not been confined to the finance sector.

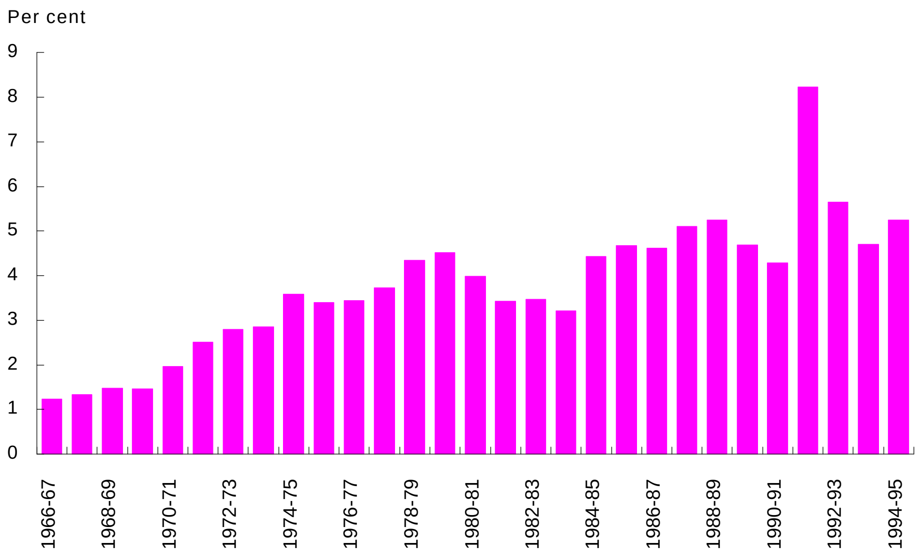
15.3.3 Dynamic Efficiency

Dynamic efficiency refers to the speed with which firms adopt new, lower cost production techniques as they become commercially available. It also refers to the ability of firms to engage actively in product innovation and to explore new market opportunities. Although the evidence presented in this section is necessarily anecdotal, it nonetheless points to a fairly consistent improvement in financial system dynamic efficiency since deregulation.

One indication of the take-up of technology is capital expenditure on equipment. Such expenditure for the finance and insurance sector (see Figure 15.4) includes items such as computer networks, automated teller machines (ATMs) and electronic funds transfer at point of sale (EFTPOS) equipment. The finance and insurance sector's proportion of economy wide capital expenditure on equipment has increased since deregulation, from about 4 per cent in 1980-81 to over 5 per cent in 1994-95. Reflected in this upward trend are a number of developments apart from deregulation, including the increasing capital intensity of finance which has been a trend evident over a long period.

Increasing Capital Expenditure on Equipment . . .

Figure 15.4: Finance Sector Gross Capital Expenditure on Equipment (per cent of total expenditure)



Source: ABS Cat. no. 5221.0.

The development over the past 10 to 15 years of derivative products which enable business to better manage risks through access to a wider range of financial instruments, is another example of innovative behaviour in the finance sector. This development should have improved dynamic efficiency.[18]

Many other product innovations which have occurred since deregulation are summarised in Table 15.4. For example, the emergence of telephone banking services over the past 5 to 10 years is likely to have yielded dynamic efficiency improvements. Originally, these services provided basic bill paying functions, through the use of credit cards. The establishment of these basic services paved the way for subsequent innovative developments in telephone banking, in that the necessary infrastructure was in place and customers had become familiar with the use of these services. More recently, technology has enabled increased functionality in telephone banking and many consumers are using the wider range of services, substituting them for costlier paper based, labour intensive transaction services.

Product Innovations Since Deregulation . . .

Table 15.4: Major Product Innovations

1980 - 1985	1985-1990	1990-1996
Card-access savings accounts	EFTPOS	Mortgage originators
PIN for debit and credit cards	ATM network linkages	giroPost
ATMs became widely available	Telephone banking	Financial EDI
Variable repayment home loans	Cash management accounts	Mortgage offset accounts
Monthly income term deposits	Housing bonds	Smart card trials
First cash management trust	Equity and fixed rate mortgage loans	Mobile lending
Compounding term deposits	Home/personal computer banking	Mobile EFTPOS (taxis)
Daily interest cheque account	Payroll system	Equity participation in SMEs
VISA and MasterCard	Increasing derivatives trading	International ATM linkages
Automatic sweep facilities		

Source: Adapted from Australian Bankers' Association, Submission No. 126, p. 38.

18 Argy 1995.

Of course, many of these innovations reflect similar innovations worldwide. Nonetheless, the less intrusive regulatory environment which deregulation helped to create should have provided financial institutions with greater competitive incentive to implement innovations. EFTPOS has been a case in point — while the technology was developed abroad, Australia has been enthusiastic in the adoption of the technology, driven by the cost and convenience benefits it yields for customers, retailers and financial institutions.

In summary, deregulation is likely to have contributed to greater efficiency in resource allocation through increased pricing efficiency in securities and foreign exchange markets. In addition, the technical efficiency of many financial institutions has increased, evidenced by lower expense ratios and increased productivity. Dynamic efficiency improvements have also occurred, with technological innovation playing a major role in these improvements.

15.4 International Competitiveness

International competitiveness refers here to the ability of Australian financial services markets to compete successfully against overseas suppliers in cross-border trade in financial services. It is a result of dynamic interactions between trading firms, suppliers, infrastructure and government regulators.[19]

It is now 13 years since a decisive further step was taken towards internationalising the Australian economy — the floating of the Australian dollar. A number of measures have since been taken to expose the finance sector directly to competition in domestic and regional markets.[20]

19 A separate consideration is the international competitiveness of Australian owned or controlled financial services firms, whether in cross-border or other trade. The Inquiry did not address this issue as it considered the performance of individual firms a matter for their management and shareholders and not the discriminatory policies of government.

20 These measures include the removal of restrictions on foreign bank entry and investment.

Financial market data show that Australia has been losing market share in comparison with some key regional financial markets. While Australia's volume of financial business has grown, business volume in Hong Kong and Singapore has increased much faster.[21] While this may be due partly to differences in economic growth rates between Australia and the Asian economies, it also suggests more fundamental problems in Australia's international competitiveness.

15.4.1 Indicators of Competitiveness

Examining time series data on trade in financial services would provide a fuller picture of changes in the international competitiveness of Australia's financial system. However, available measures are limited in scope. The lack of data arguably has contributed to limiting policy focus on the potential export role of the finance sector. The limited data available, which are presented below, provide some support for the view that underlying international competitiveness has improved since deregulation for some financial markets but deteriorated for others.

Trade in Financial Services

Financial services trade data are available only for fee based sales of financial services (see Figure 15.5). The ABS measure includes fees and charges associated with banking transactions, loan raising and funds transfer services, underwriting and brokerage, and commissions associated with share transactions and investment activity, finance, leasing and account management.[22] Despite their limitations, the data provide an indication of trends in financial services trade.

21 Allen Consulting Group and Arthur Andersen 1996.

22 The ABS measure of financial services trade excludes fees associated with professional services. Profits earned overseas by Australian financial institutions and repatriated to Australia are not included as exports of financial services.

Fee Based Trade in Financial Services is Increasing . . .

Figure 15.5: Trade Balance on Financial Services

Source: ABS Cat. no. 5363.0.

Figure 15.5 shows that, in the past decade, fee based financial services trade has moved from deficit to surplus, thus providing some evidence of an underlying improvement in international trade in financial services since deregulation.[23]

Weaknesses in the international collection of financial and insurance services data make it impossible to present an accurate picture of how Australian trade in these services compares with that of our major trading partners. However, using OECD statistics alone (and putting aside their limitations), the broad picture that emerges is that Australia's financial and insurance

23 Not all financial services share this trend. While data for insurance services are not included because of their poor quality, they indicate that trade in insurance services has been in deficit over the period 1984-85 to 1995-96.

services trade is significantly smaller than that of many other OECD countries.[24]

Australia as a Regional Financial Centre

The growth of trade in financial services and repatriated profits depends partly on the extent to which Australian institutions are integrated into overseas financial markets and the attractiveness of Australia as a destination for inwards investment to service regional or global capital markets.

In 1996, the Allen Consulting Group undertook a study to ascertain Australia's attractiveness as a regional financial services centre.[25] Their survey found that:

- Australia is considered to be equal with Tokyo in the quality of financial services it provides to the Asia Pacific region, but considerably behind Hong Kong and Singapore;
- on many important features, such as the critical issues of depth, liquidity and maturity of financial markets, Australia ranks considerably behind Hong Kong and Singapore (see Table 15.5); and
- as shown in Table 15.6, Australia is rated as the best by a clear margin on the integrity of its legal and regulatory system, as it is on other 'environmental' features.

The measures undertaken as part of deregulation (including removal of interest rate and lending controls, removal of constraints on capital inflows and outflows, and floating of the dollar) may have contributed to the favourable rating of Australia's regulatory system. Overall, however, the results suggest scope for improvement (see Chapter 11).

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24 Department of Foreign Affairs and Trade, Submission No. 248.

25 Allen Consulting Group & Arthur Andersen 1996. The study included a survey and structured interviews of 46 senior decision makers in Australia, other Asia Pacific and major US and European financial centres.

Australia's Financial Product Quality Rating is Relatively Low . . .

Table 15.5: Users' Ratings of Products (per cent rated good or very good)

	Australia	Hong Kong	Singapore
Portfolio management	36	36	30
Retail funds management	55	27	40
Derivatives	55	64	80
Foreign exchange	55	82	82
Cash management	58	64	73
Insurance	58	36	50
Corporate banking	58	82	73
Debt issues	55	60	70
Fixed interest securities trading	55	55	40
Equity issues	55	36	40
Equities trading	46	46	40
Advisory functions	64	50	40
Overall rating	69	75	75

Source: The Allen Consulting Group & Arthur Andersen, 1996.

Australia Rates Relatively Well on Environmental Features . . .

Table 15.6: Users' ratings of Environmental Features (per cent rated good or very good)

	Australia	Hong Kong	Singapore
Legal/regulatory system	92	83	83
Communications and travel	77	75	83
Supply and affordability of skilled professionals	69	33	33
Availability of support services	77	75	75
Liquidity and maturity of financial markets	77	83	83
Size and strength of domestic markets	69	75	67
Proximity of major service providers	77	75	83
Price	42	46	46
Average	73	68	69

Source: The Allen Consulting Group & Arthur Andersen, 1996.

15.5 Choice of Financial Products

In this section, the increased product choice available to consumers is examined by assessing changes in the number and range of institutions in the system and the products they offer. Both retail and wholesale financial services are considered, the distinction between the two being the level of sophistication of the user and the size and frequency of transactions.

The discussion in this section is organised to correspond with four primary functions of the financial system:

- pooling and allocation of financial resources (including provision of liquidity);
- provision of payments services;
- risk management and allocation; and
- provision of information.

Hard data on product choice (and quality) in the financial system are lacking. Where available, such data are presented but the analysis often relies, of necessity, on more qualitative and impressionistic observation.

15.5.1 Pooling and Allocation of Financial Resources

The financial products which facilitate the pooling and allocation of financial resources include, on the retail side, home mortgages, deposit and saving products and, on the wholesale side, short-term and long-term debt and equity instruments.

Several events resulted in improvements in both the choice and quality of products performing this function over the 1980s. Interest rate ceilings on deposits were removed from December 1980 and controls on maximum and minimum terms on fixed deposits were progressively removed, and finally abolished in 1984. In 1985, 16 foreign banks were invited to establish trading operations in Australia. These changes increased both the range of products which banks could offer and the number of competitors in the finance sector.

In addition, as part of the Government's initiatives to encourage greater self-provision in retirement, mandatory contributions to occupational superannuation schemes were introduced in 1986. Financial institutions responded to the resulting flow of household savings into superannuation vehicles by increasing the range of such products on offer.

Credit Products

Prior to 1980, the 13 savings banks and 118 permanent building societies in operation were the main sources of finance for home ownership, with the former providing 43 per cent of total housing finance and the latter 33 per cent in 1980. Each offered an average of two varieties of mortgage products.[26] These loans were also fairly basic, with limited flexibility in their terms and conditions, certainly by current standards. Indeed, submissions to the Campbell Committee suggested that finance for home ownership was an area in which product innovation should be encouraged.

While there was some variety in the home mortgage products on offer, access for many consumers was limited by restrictive qualifying criteria. These criteria prevailed because of the various regulatory restrictions which resulted in excess demand for credit relative to supply — requiring available credit to be rationed in some manner. In particular, ceilings were imposed on interest rates charged by savings banks for home loans of less than $100,000. Building society interest rates were regulated in some States and suasion was often brought to bear, reinforced by the possibility that controls may be introduced if rates were raised above the 'desired level'.[27]

Thus, it was not uncommon for lending institutions to restrict finance for housing only to customers whose income, collateral or demonstrated record of saving recommended them as high quality credits. Even if a borrower met these criteria, it was still necessary for most to obtain supplementary finance, often from unregulated sources, including insurance and finance companies, solicitors' trust funds or members of the borrower's family.

26 Joss 1996 and Australian Financial System Inquiry 1981, p. 633.
27 Australian Financial System Inquiry 1981, p. 636.

Today, both choice of, and access to, home loan products are substantially greater. The total number of home loan commitments in 1995-96 was 451,535, up 77 per cent compared with 254,894 commitments in 1976-77 (see Figure 15.6). This compares with population growth of 29 per cent over the same period.[28] In 1996, consumers were able to choose from approximately 1,760 differentiated mortgage products offered by a range of suppliers.[29] This figure includes a spectrum of residential, investment and equity mortgages offered by 150 financial institutions, each offering an average of 12 different mortgage products. While many of the differentiating characteristics are minor variations of particular elements, more substantial differentiating features include variable and fixed interest rate facilities, 'honeymoon' interest rates, redraw facilities and arrangements for setting off interest between savings and loan balances.[30]

The entry of new suppliers into the home loan market was encouraged by the removal of controls on interest rates, enabling such rates to be determined by market forces. More recently, the increasing use of securitisation, which represents a lower cost method of providing home loans, has enabled mortgage originators to enter the home loan market and bid down prevailing mortgage interest rates. The rapid growth of mortgage securitisers has turned the market for housing finance into one of the most competitive segments of the Australian financial system.

The use of other credit products, such as revolving credit and personal loans, increased substantially over the 1970s, with balances outstanding rising from $1.6 billion in 1970 to $6.7 billion in 1979.[31] This growth was driven to a large extent by the decision in 1966 to allow banks to make personal instalment loans above the maximum overdraft limits. Following this decision, Bankcard, a payments card with instalment credit options, was introduced in 1974.

28 ABS 1986, Cat. no. 3101.0.

29 Advice provided to the Inquiry by Cannex (Aust).

30 'Honeymoon' rates refer to the lower rates of interest which often apply to home loans for an initial period. Redraw facilities refer to the option attached to some loans of re-borrowing a discrete amount of the original loan principal, depending on the amount already repaid.

31 Australian Financial System Inquiry 1980, p. 21.

Increased Home Lending Commitments . . .

Figure 15.6: Number of Home Lending Commitments, by Lender

Source: ABS Cat. no. 5609.0.

In the early 1980s, two other credit card providers, VISA and MasterCard, entered the Australian market. The number of credit card holders in Australia increased from three million in 1980 to seven million in 1996.[32]

Deposit Products

Prior to the 1980s, the range of deposit products available to most consumers consisted of passbook accounts and term deposits. Only a small number of consumers, often those running businesses, had personal cheque accounts. Cheque accounts were held with one of the 10 trading banks, and each bank offered only a single type of cheque account product in 1980.[33]

The choice of deposit products available to consumers has subsequently increased, with almost 1,800 different types of deposit accounts on offer at

32 Joss 1996.
33 Joss 1996.

the end of 1996.[34] The types of accounts available include special purpose accounts (travel, Christmas, business, student, etc), cash management accounts and others differentiated according to the length of notice required for withdrawals and the method of calculating interest. Again, the bulk of the differentiating characteristics are minor.

Also, in 1995 the PSA recommended that financial institutions review and adjust their fee structures to achieve better relativity between the fees and costs of individual components of account products.[35] As a consequence, many financial institutions introduced basic retail transaction accounts which were designed to help customers minimise the fees and charges they incur in transacting.

Recent data show that an estimated 39 per cent of the Australian population used cheques in September 1996, implying that at least this proportion of the population has access to cheque account facilities.[36]

Comprehensive banking service packages are an innovation to emerge during the last year. These include various combinations of savings, loan (including lines of credit) and transaction services. Some include full interest offset with no formal loan instalments, no monthly repayments and full, automatic redraw. Life insurance products are also now included in some packages. Such packages aim to provide convenience in financial management to consumers and small businesses and to promote longer-term customer relationships. They also contribute to greater product choice, flexibility and convenience for consumers.

Long-Term Savings Products

At the time of the Campbell Inquiry, a moderately extensive range of long-term savings products was available, including term deposit and trust products, government bonds and insurance bonds. The first cash management trust in Australia was established in 1980.[37] However, in some cases, consumers were denied access to these instruments by minimum

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34 Data provided to the Inquiry by Cannex (Aust).
35 PSA 1995, p. xlvi.
36 Information compiled for the Inquiry by Roy Morgan Research.
37 Lewis & Wallace (ed.) 1993, p. 149.

subscription values. This was true of some term deposits, Commonwealth bonds, certain unit trusts and life insurance bonds. Small investors could access a range of long-term savings products through intermediaries, including life company and pension funds, property and equity trusts and cash management trusts. Such access, however, was at a higher cost than that for larger investors.[38]

Today, access is easier since minimum investment amounts have fallen in many cases (eg life insurance bonds), as corporate debt markets have deepened and financial markets around the world have become increasingly integrated and competitive.

A number of new products emerged during the 1980s, including compounding term deposits, master trusts, and market linked insurance products. Retirement incomes policy has encouraged these developments by promoting a shift in household savings away from traditional deposits towards managed investment products. Prior to these policy initiatives, most people did not have superannuation, with options limited to employer schemes for those who did. Private sector employees seeking to accumulate a retirement benefit often had to arrange their own personal policy with a life company or superannuation fund. Today, the range of superannuation products on offer is clearly much larger, although some restrictions on access and choice exist (see Chapter 11).

Capital Raising Instruments

It is difficult to discern from available data the extent to which fundraising options open to wholesale consumers of financial services broadened over the 1980s. It has been suggested that, today, the equity market in Australia remains deep only for mid-size and large listed companies and quite thin for the smallest.[39]

The Campbell Committee was of the view that most of the perceived difficulties in small business access to equity finance ‘simply reflect the economic fact of the higher cost of investing in small amounts and the

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38 Australian Financial System Inquiry 1981, p. 727.
39 Allen Consulting Group, 1996.

higher risk of investing in small businesses, especially if the scope for effective spreading of the risks were limited'.[40]

The claim that small to medium size enterprises (SMEs) are disadvantaged in their access to capital was also examined by the Industry Commission (IC) in 1991.[41] The IC found that banks were providing a much wider range of financial products and were able to lend to more small business clients than was possible in the era of financial regulation.

The IC also pointed to the rapid growth in specialist providers of equity to smaller ventures through the 1980s, initially in response to the Management and Investment Companies scheme. However, the performance of venture capitalists since the 1980s has been poor, and this has affected their ability to attract capital. Shortage of appropriate management skills and worthwhile projects were cited as reasons for the poor performance.

Despite informational, managerial and start-up cost issues associated with venture/development capital companies, in 1993-94 at least 12 new companies were established and a further 12 were formed by established companies (four companies left the sector). The Pooled Development Fund Scheme was a catalyst in this record number of new entrants and funds.[42] The objective of the scheme, introduced in 1992, was to encourage the supply of equity capital to SMEs whose primary objects were neither retail operations nor land development.

Medium sized Australian companies involved in high-technology and risky activities which, in the past, experienced difficulty raising capital are now able to raise equity on specialised exchanges in the United States. For example, a growing number of Australian companies are listing on NASDAQ, which specialises in providing a market for non-blue chip equity and venture capital.

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40 Australian Financial System Inquiry 1981, p. 690.
41 Industry Commission 1991, p. xvii.
42 Marsden Jacob Associates 1995, p. 60.

15.5.2 Provision of Payments Services

Services falling within this category range from cash, payment orders and cheques to sophisticated electronic clearing and settlement networks of domestic and, in some cases, international financial service providers (see Chapters 6 and 9 for more detail). A primary objective of payments services is to facilitate trade and commerce, thus promoting economic growth.

Technology and the increasing integration of international financial markets have played a major role in improving the choice and quality of payments services. Technological developments over the past 15 years, including increased computer network power and security and declining telecommunications costs, have driven the transition from paper based payments services to lower cost electronic services. At the time of the Campbell Report, the move away from transported paper documentation towards electronic means of transfer was just beginning.[43]

The Campbell Committee recommended that banks should remain the only financial institutions upon which cheques can be drawn. Apart from this, there would be no further legal barrier to the participation of any class of business or person in the provision of payments system services.[44]

For retail consumers, the choice of payments services and providers of these services has increased substantially over the past 10 to 15 years. Whereas cash, cheques, payment orders and credit cards were previously the main retail transaction mechanisms, these were supplemented by EFTPOS in the mid-1980s and by giroPost in 1995. The entry of international credit card products (discussed above) also contributed to more intense competition in the payments systems area.

Major changes in wholesale payments services have also occurred, owing largely to technological advances and global financial market integration. These changes have affected the nature of services available as well as access to these services. In particular, in 1980, there were three centralised clearing mechanisms for non-cash payments:

43 Australian Financial System Inquiry 1981, p. 408.
44 Australian Financial System Inquiry 1981, p. 418.

- the Australian Clearing House Association, which limited membership to a number of banks that directly exchanged and cleared cheques;
- the Central Magnetic Tape Exchange (CEMTEX), which was also established by banks to act as an automated clearing house for direct entry transactions; and
- Charge Card Services Limited, which was owned by five banks and processed all Bankcard transactions.[45]

Given the larger number of banks now operating, there are more participants in the cheque clearing system, both direct clearers and those operating through agency arrangements. There are about 60 agency arrangements between banks and non-bank organisations (building societies, credit unions and cash management trusts) for the issuing of cheques. In addition, non-bank financial institutions now have the right to participate, via agency arrangements, in the paper clearing system.

Non-banks are also able to issue, and have drawn upon them, payment orders (which are functionally no different from cheques). However, in practice most non-banks providing cheque facilities to their customers do so by issuing cheques through agency arrangements with banks.

Exchange settlement accounts held at the RBA were granted to Special Service Providers owned and operated by the building society and credit union industries in 1994. As a result, these institutions now enjoy more direct access to the payments system, potentially greater control over clearing costs, and greater privacy in that the banks with which they had arrangements are no longer privy to their transactions data in the consumer electronic and bulk electronic clearing systems.

The recommendation of the Martin Review Group in 1984 that non-banks be encouraged to participate in CEMTEX was implemented almost immediately. CEMTEX was disbanded in 1984 and magnetic tapes for direct entry were subsequently exchanged bilaterally between banks. Building societies and credit unions developed their own separate direct entry systems through their respective industry organisations. Such arrangements

45 Australian Payments Clearing Association, Submission No. 33.

operated alongside the longer-established system operated by banks. All three systems were linked in March 1994 under the regulatory umbrella of the Australian Payments Clearing Association (APCA).

The introduction of financial Electronic Data Interchange (EDI) is an example of a wholesale payment service which has developed as a result of technological innovation. EDI is the electronic transfer of business information, such as a remittance advice relating to a purchase of goods or services and may include the corresponding payment message, between trading partners. Although the finance sector is beginning to use financial EDI, the number of EDI generated payments is still relatively small.[46] Other technology driven payments services introduced since the early 1980s include:

- **Austraclear —** a public company formed in 1984 to provide registry, depository and trading facilities for private sector and semi-government securities.
- **Bank Interchange and Transfer System (BITS)**, introduced in 1987 — a domestic interbank electronic funds transfer system for large value interbank money market and foreign exchange transactions.
- **Reserve Bank Information and Transfer System (RITS)** — a system introduced in 1991 to provide registry, depository and trading facilities for Commonwealth Government securities. (Members of RITS include all banks and other major traders of Commonwealth Government securities; non-bank members, other than credit unions and building societies, must have a member bank take responsibility for their payments.)

15.5.3 Risk Management and Allocation

Derivatives and other hedging contracts facilitate the management of risk by providing parties with a contracted fixed price for an underlying asset in the event of specified conditions being realised. Insurance products are also used to manage risk and involve parties paying a specified premium for this service. Such products enable parties to transact with greater certainty and

46 Cutler & Company 1995.

to transfer risk to others whose specialist skills in risk management enable them to bear risk at lower cost.

Changes in the choice of risk products cannot be attributed specifically to financial deregulation. In fact, until 1986, the general insurance sector was relatively lightly regulated — there were few restrictions on the types of products offered. In 1986, the *Insurance Contracts Act 1984* codified existing common law obligations.

The economic cycle is probably the main factor influencing the range of general insurance products demanded by consumers at a particular time. Thus the types of general insurance products available have remained essentially unchanged, at least since the 1970s.

The story is somewhat different for life insurance products. In the 1970s and early 1980s, whole-of-life and annuity products were the main types of products available.[47] Life insurance products have subsequently unbundled, with the range of market linked products increasing, largely as a result of the shift of household saving noted above. Pure risk insurance products have become more flexible, with consumers able to buy insurance products tailored more closely to their individual needs.

The range of institutions from which customers can purchase life insurance products has expanded from life companies, life agents and brokers to include banks and superannuation funds. Around half of new business written by life companies is now distributed through investment advisers, securities dealers, multi-agents and bank branches, which operate as distribution channels for the banks' subsidiary life companies. New life business is also being generated through packaging with superannuation products.

Improvements in the choice of risk management products available to wholesale consumers have been evident since the early 1980s. These changes reflect the increased need for risk management products in a more volatile

47 Whole-of-life insurance products are those for which cover is provided for the remaining lifetime of the individual, usually at a constant annual premium rate. Annuities involve the insurer agreeing to pay a fixed sum per year from the start date of the contract until the individual's death, in return for a single lump sum premium, paid in advance.

financial environment, following the floating of the exchange rate and the globalisation of financial markets. In the early 1970s, the set of available risk management products consisted of foreign exchange forward contracts, which were available through authorised banks only until 1975, and 90 day bank bill futures (available from 1979).

Prior to the implementation of the Campbell Committee's recommendations, an official forward deliverable market operated for foreign exchange. Trades were restricted to the hedging of foreign trade and certain capital transactions. Because of this restriction, an unofficial forward foreign exchange market (undeliverable) also operated, in which other transactions could be hedged. Following the Campbell Inquiry, the official market was closed and all forward trade in foreign exchange occurred in the one deliverable market.

Derivative products and markets have developed in the past decade both domestically and internationally. The Sydney Futures Exchange now offers 19 types of futures and options contracts which trade up to 21 hours per day. Such contracts include share price index and share futures, 90 day bank bill futures and options, three and 10 year Treasury Bond futures and options, and overnight three and 10 year Treasury Bond options. In addition, options over 50 stocks and share price indexes are now tradeable on the Australian Stock Exchange. As well as traditional options, the range now includes spot-month options, long-term options, flexible (or tailored) options and low exercise price options.

15.5.4 Provision of Information

Products and services performing this function are designed to facilitate informed decision making. If consumers are making the right choices according to their needs, prices should reflect accurately their willingness to pay for particular products and, accordingly, resources should be allocated efficiently. Alternatively, if consumers are not well informed, they cannot take advantage of the available product range, which in turn limits mobility and competition.

In many cases, the widening of choice and access described in previous sections is partly attributable to the fact that households have become more aware of, and responsive to, differences in the pricing and other characteristics of financial products. Consumer protection initiatives over the 1980s, including increased information disclosure for various products and the establishment of alternative dispute resolution schemes, have facilitated these developments.

Prior to the 1980s, the choice of information sources for many consumers was relatively small. The few generalist information services available tended to be targeted towards higher income groups and business.

Few investment advisers were in operation in the post World War II era and most were tied to a small range of branded investment products. Consumers seeking advice approached stockbrokers, accountants, solicitors, real estate agents, banks, trustees and life companies.[48]

A feature of the increased range of products now available has been an increase in the complexity of products and the difficulty of making direct product comparisons. This is often argued to be a cost borne by consumers.[49] A major expansion in the financial planning industry has occurred since the 1980s. In 1996, there were approximately 1,751 licensed dealers and investment advisers and approximately 30,000 proper authority holders, which include funds managers and their representatives.[50] These advisers provided services to over two million consumers in 1995. Other sources of specialist advice, including accountants, solicitors and real estate agents, retain significant roles.

Free financial advice has been offered by the Insurance and Superannuation Commission and the Department of Social Security since the mid-1980s. Magazines and specialist newspaper columns on personal investment strategies are another relatively recent development.

48 Financial Planning Association of Australia, Submission No. 54.
49 Australian Consumers' Association, Submission No. 153.
50 Financial Planning Association of Australia, Submission No. 54.

15.6 Quality of Financial Products and Services

Improvements in product quality are assessed by gauging the extent to which financial products meet the particular needs of consumers. Leaving aside pricing issues and choice, which were considered earlier in this chapter, degrees of convenience, overall service levels, and the availability of information are all part of overall consumer satisfaction. Customer research on such issues is one element in the Inquiry’s determination of the extent of quality improvement since the early 1980s.

Dissatisfaction expressed by consumers often combines several of these factors. For example, although the choice of long-term savings products widened over the 1980s (owing largely to government retirement incomes policy), the perceived quality of these products did not necessarily improve. A 1992 survey by the then Trade Practices Commission suggested that many consumers were dissatisfied with their life insurance and superannuation products.[51] The survey suggested that such products were not perceived to be flexible and that consumers felt they had inadequate information to understand and evaluate these products. In addition, high up-front costs and penalties for early termination were considered unattractive features.

Three key dimensions of product and service quality — convenience, overall service levels and the usefulness of product information — are discussed in more detail below.

15.6.1 Convenience

An important aspect of quality is convenience. The introduction of telephone banking, as well as EFTPOS in the mid-1980s and ATMs in the late 1970s, promoted greater convenience in accessing retail credit and deposit products. Most deposit taking institutions now provide free telephone services, which enable customers to make account inquiries and transfers 24 hours per day, seven days per week.

51 TPC 1992.

In 1996, there were 116,704 EFTPOS terminals and 7,240 ATMs in Australia. In addition, banks operated 6,507 branches and 11,956 agencies in 1996.[52] Data limitations prevent direct comparison of the current number of access points with that prevailing in the 1980s. However, in 1980, prior to the introduction of EFTPOS and the widespread use of ATMs, there were approximately 11,760 bank branches in operation in Australia.[53] These improvements in convenience, and hence quality, were the result primarily of technological developments which in turn facilitated the development of alternative electronic distribution channels.

There is some evidence of quality improvements in retail payments services over the past 10 to 15 years, particularly in terms of increased convenience. Prior to the 1980s, retail consumers experienced considerable inconvenience in accessing funds while interstate. Consumers could access funds only by prior arrangement with their bank managers, and often incurred a charge for such access. Technological developments over the 1980s, resulting in the formation of national ATM and EFTPOS networks, have dramatically increased the number of access points domestically.

Until recently, access to funds by Australians travelling overseas was primarily by pre-purchased traveller's cheques and telegraphic wire transfers. As a result of technological developments over the past few years, international ATM networks, such as Cirrus (debit card based) and Maestro (credit card based), have greatly improved convenience in accessing funds internationally.

Merchant acceptance of credit cards has also become more widespread in the past five years (both domestically and internationally) and is extending to public utility organisations and other service providers offering pay-by-phone services. Numerous public utilities now accept automatic account debit arrangements.

With regard to quality improvements in wholesale payments, work is under way within APCA to shorten clearance times for cheques, especially

52 APSC 1996, *Annual Report 1995/96* and RBA 1996, *Reserve Bank of Australia Bulletin*, December edition.

53 PSA 1995, p. F-4 and ABS 1986, Cat. no. 3101.0.

dishonours, through the use of electronic messaging. The efficiency of the cheque clearing system is discussed in detail in Chapter 6.

15.6.2 Service Levels

The evidence on service levels in financial services for businesses indicates an overall improvement, despite setbacks in some areas. Results of ACCI's 1996 member survey indicate that there has been some improvement in the services offered in financial markets over the past 10 years (see Table 15.7). Although more distant time periods are seen as having provided a higher level of financial service than more recent periods, the present position is regarded as superior to conditions which existed in the 1980s.

The ACCI survey also found that the majority of businesses are able to secure the funds they seek and that the loan or overdraft arrangements with their financial institutions are satisfactory. Two-thirds of respondents stated that their loan arrangements were either satisfactory or very satisfactory. More than three-quarters indicated that their loan represented the amount originally sought from their financial institutions.

Service Levels have Improved over the Past Decade . . .

Table 15.7: A Comparison of Service Levels: 1, 5 and 10 Years

	Services Received (per cent)				
	Far better	Better	No difference	Worse	Far worse
Comparison with 1 year ago	7.9	36.2	45.8	8.5	1.7
Comparison with 5 years ago	17.5	37.9	23.2	15.3	6.2
Comparison with 10 years ago	26.6	29.6	16.0	14.8	13.0

Source: Australian Chamber of Commerce and Industry, Supplementary Submission No. 121, p. 4.

Nonetheless, some remaining areas of concern to business are the level of interest rates, fees, charges and collateral requirements imposed by financial institutions. These were also cited as areas of concern by some small business groups (eg respondents to the Printing Industries Association of Australia member survey, 75 per cent of which were small companies employing between one and 19 employees). A large proportion of respondents to this survey (34.9 per cent) also believed that lending criteria had become more restrictive in recent years.[54]

In addition, more than one-third of the small businesses surveyed in the Yellow Pages Small Business Index in August 1995 reported that they were constrained by lack of capital. Of those reportedly capital constrained, 20 per cent said that they had experienced difficulty in obtaining finance. Nonetheless, in the same survey almost 80 per cent of small business proprietors claimed to be happy with their main bank in 1995, a satisfaction level little changed from that indicated in the 1993 survey.

15.6.3 Usefulness of Information

The quality of information is reflected in its usefulness to consumers, in making decisions as well as in helping them to 'navigate' the financial system. The available evidence suggests that the quality of information is one area in which financial deregulation and other developments of the 1980s have not yielded expected benefits.

Roy Morgan data on overall customer satisfaction levels with their deposit taking institution indicate that the proportion of customers either 'satisfied' or 'very satisfied' with their institution increased for credit unions and building societies over the period 1993 to 1996.[55] This proportion fell slightly for regional banks and the major banks, and remained largely unchanged for foreign banks over the same period. As noted in Chapter 10, the proportion of satisfied or very satisfied customers is highest for credit unions and building societies (around 85 per cent in 1996), and lowest for the major banks (around 70 per cent).

54 Printing Industries Association of Australia, Submission No. 213.
55 Information compiled for the Inquiry by Roy Morgan Research.

A recent survey for the Credit Union Services Corporation (Australia) Limited found that decision making by consumers of long-term saving products is frustrated by limited product knowledge and a limited preparedness to deal with some institutions. The survey found that consumers assume that different products share similar characteristics, depending upon which institution is offering them. For example, bank products, particularly term deposits, are considered to be more liquid than the products that are more liquid in reality, such as some managed investment products. [56]

A similar story can be told for risk management products. For example, a Trade Practices Commission survey revealed that consumers were unaware of the bias imparted by the restriction on the ability of life insurance agents to advise beyond a limited range of products.[57] The survey found the provision of key product information to be largely at the discretion of the agent, with consumers not knowing what critical information to seek. Consumers complained that key terms were not explained or that they were misinformed about the nature of the policy or the consequences of early termination.

Problems in this area are not limited to retail consumers. The Australian Chamber of Manufactures recently undertook a survey of 755 manufacturers concerning the level and adequacy of services provided by the banking sector to Australian manufacturers. The survey indicated that manufacturers seeking tailored services which met specific needs found that in all cases, the ability of banks to provide them with useful information and advice was deficient.[58]

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56 Eureka Strategic Research included in Credit Union Services Corporation (Australia) Limited, Submission No. 162.

57 TPC 1992.

58 Australian Chamber of Manufactures, Submission No. 262.

15.7 Conclusion

Without being the only factor involved, deregulation has facilitated improvements in competition and efficiency in the Australian financial system.

Although the increase in competition expected to flow from deregulation — particularly in the retail deposit taking sector — has been slow to arise, some retail financial markets have become obviously more competitive in recent times.

Increased pricing efficiency in securities and foreign exchange markets in particular, has improved resource allocation. The productivity of finance sector participants has risen in many cases, as has their dynamic efficiency, with technological innovation playing a major role in these improvements. The consequences of deregulation for the international competitiveness of Australian financial service markets are less convincing. Underlying international competitiveness has increased since deregulation for some financial markets but deteriorated for others.

From the evidence presented above, it is clear that product choice has widened since the early 1980s. This is attributable to deregulation, as well as to technological developments, Government superannuation initiatives and the increasing integration of international financial markets. The quality of financial products has also improved. One major exception to the improvement of financial products and services is the provision of information and advice, which still appears to be in need of further development.

In all of these areas, however, there are equal grounds for concluding that deregulation has been neither complete, nor completely effective, in all respects. Although deregulation has yielded benefits, there is still room for further improvement.