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Financial institutions spend billions to exploit people's uneasiness to their profit when better loan deals are available

Wouldn't it be nice to decide how much you were worth? And wouldn't it be even better to be able to force people to give you the money you think you deserve? Of course it would, but then again, we can't all behave like the big four banks.

In most industries when customers buy less of your product your profits begin to decline. But not, it seems, in banking. In banking, the bankers tell us, if the rate of growth in borrowing begins to decline then the profit margin on their existing loans simply needs to rise. Otherwise their profit growth would slow, and we obviously couldn't have that.

In most industries, if your competitors start a price war with you then your profits will begin to decline. But again, the bankers would beg to differ. If credit unions and building societies push up the interest rates on fixed-term deposits then the banks will simply have to increase their mortgage rates. Otherwise, profit growth would slow, and we obviously couldn't have that.

But the banks are not like other industries. Not only does the oligopoly of the big four banks dominate the financial system in a way few chief executive officers could dream of, but the banking industry itself has effectively become an essential service that customers, no matter how aggrieved, cannot avoid using.

Try asking your boss to pay you in cash. Try asking Centrelink to pay you in cash. Adults in Australia are effectively forced into having a bank account and, in turn, to paying fees and charges to access their own money. Transaction fees in excess of the trivial transaction costs are, in effect, a transaction tax. But while taxes usually accrue to the government, bank fees accrue to the big banks.

Of course while we may have no choice in using the banking system we do have some choice in which institutions we use, and while the government will soon introduce measures to make it easier for people to switch banks such measures will have little impact unless the government works hard to explain to Australians just how much they will save if they swap.

The banks will certainly spend up big in order to suggest there is no need to swap.

The banks spend about $1 billion a year on advertising, which is more than it costs the ABC to collect and report news from around the world. The banks tell us repeatedly that when interest rates go up they have no choice but to pass on the cost increases to consumers so it might follow that the billion-dollar cost of their advertisements is also passed straight on to customers.

So if the big banks have to cover the costs of expensive advertising how could they offer a better deal than the smaller banks, credit unions and building societies?

The short answer is, they can't.

Economists typically assume that consumers are "rational" and, in turn, that they will collect lots of information, compare all of the products on offer, and then choose the cheapest one. The marketing industry, on the other hand, typically assumes that people are "busy" and, in turn, won't have time to shop around, won't know how to compare complex product disclosure statements, and will often be afraid of buying the cheapest option as they don't like to take risks when buying products that they know they don't really understand.

When it comes to banking, either the economists or the marketers are right. My money, like the bankers' advertising budget, is on the marketers having the more realistic world view.

Consider the following. Imagine that you had borrowed $500,000 for a home from one of the big four banks.

Now imagine that you were told that you could switch to another bank and pay a 0.1 per cent lower rate. Would you fill out a form to get that?

There is, of course, no right answer. But would your answer be any different if I asked you whether you would be willing to fill out a form if it meant I would post you a cheque for $500 a year for the next 20 years?

What if I offered to post you a cheque for $2500 per year for the next 20 years? That would be the equivalent of switching to a mortgage rate that was 0.5 per cent lower. If you could save a full 1 per cent that would be the equivalent of someone posting you $5000 per year for 20 years.

But the big banks know that most Australians won't switch. They know that people feel too busy. They know that people don't trust that once they switch the interest rate of their new bank will remain low. And, ironically, the big banks know that most Australians have been trained to mistrust better banking deals.

"Everyone knows there is a trade-off between risk and return". "If it sounds too good to be true then it probably is". The big banks reinforce such "common sense" attitudes to investment risk to keep most customers from even considering switching to a much better deal. Smaller banks and credit unions might be cheaper, but are they safe?

Of course they are. This is the main problem that the government, the Treasury, the Reserve Bank of Australia and the Australian Prudential Regulation Authority should all be addressing. It is one thing to introduce a new form to make it easier for people to switch, but the main problem is the psychological barriers that the banks have spent $1 billion a year constructing.

If you borrowed $500,000 from a credit union and, in a very unlikely turn of events, they went broke, what risk would you face? Would you be concerned they might forget to ask for the money you owe?

Australia's banks are among the most profitable in the world. They have the power to set interest rate margins based on their desired rate of profit growth. Customers have a role to play in putting pressure on them, but they would be better equipped to do that if the government put as much effort into telling consumers about the benefits of switching as they did into telling us how lucky we are to have such profitable banks.

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