"Do bank charges play a key role in determining bank-client relationship? The case of South Africa"

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Abstract

Conventional theory on the subject of relationships between banks and their clients suggest that there are many factors that are at play in determining the relationship between banks and their clients. Evidence from recent research indicates that the majority of banks at global level are increasingly coming under pressure from shareholders to deliver an acceptable return on investment. With thinning interest margins due to increased competition at global level banks have resorted to another source of income, bank charges in a bid it improve on shareholder return on investment. This has resulted in banks loosing patronage to and the immergence of non-banking sector financial institutions. In the context of South Africa, this has led to non-banking sector financial institutions (NBFIs) being observed as offering alternative banking avenues thus competing with banks in the provision of financial services. It is against this background that this research study has investigated whether bank charges are a key determinant to the bank/client relationship in South Africa. Results derived from the study based on regression analysis indicate no significant association between bank charges and bank/client relationship thus suggesting that bank charges are not a significant threat to banks/client relationship and therefore not a threat to the relationship between banks and their clients in context of the South African economy.

Introduction

The significance of the capital market, especially banks as agents of intermediation cannot be over emphasized. As critical role-players in the economy, they mobilize deposits from surplus units and lend to deficit units. They attract deposits at lower cost and lend at a premium in order to advance their profit motives. In the process, they contribute to the development of the economy as they facilitate the national payment system, advance loans to major economic players who then use the funds for infrastructure development, for job creation and other economic activities that benefit the society at large. As business units, banks are also expected to grow their profits consistently as the investors into these banks look for higher returns on their investments. A number of strategies have been employed all along but of late relationship banking and relationship marketing have become crucial for long term relationships.

There has however been growing pressure on bank profitability since the early 1990s as a result of competition and other pressures and while the process of profit maximization has been waned through still and intense competition from the other financial institutions, a complementary avenue was devised – bank charges. Bank charges or the term bank charge covers all charges and fees made by a bank to their customers. In common parlance, the term often relates to charges in respect of personal current accounts or cheque account. These charges may take many forms including but not limited to monthly charges for the provision of an account, charges for a specific transaction (other than overdraft limit excesses), interest in respect of overdrafts (whether authorized or unauthorized by the bank) and charges for exceeding authorized overdraft limits, or making payments (or attempting to make payments) where no authorized overdrafts exists.

Evidence suggests that the introduction of banks charges has led to banks *loosing patronage to and the immergence of non banking sector financial institutions.* This has put pressure on banks to review their bank charges downwards as they are perceived as being steep by a number of constituencies within the South African economy. Growing consumerism, the enactment of new legislation in support of the consumer and intense pressure from other stake holders mean that the issue of bank charges and their impact on relationships and on the role of banks as intermediators can no longer be ignored. This paper investigates the impact of bank charges on the relationship of banks and their clients.

Banks are an important component of any economy. According to Mayer et al. (1981) banks "our most important institutions as they create the bulk of our money stock and have such a wide range of activities; they are department stores of financial finance" (Mayer et al., 1981), and therefore play a major role in lives. The behavior of banks is relevant for monetary policy which in turn has an influence on the performance of the economy and an indirect influence on lives. At personal level the public may be affected by the behavior of banks in one way or another as either, borrowers, depositors or consumers of other banking services. In the realm of financial intermediation, Diamond (1984) postulates that banks play a special role of providing liquidity and financing investment projects of borrowers which capital markets would not

be able to do efficiently. It is in this respect that banks are therefore regarded as the primary conduit between savers and borrowers for intermediation purposes.

According to Gurley and Shaw (1960) and Hester (1969), financial intermediation is a process where financial transactions between borrowers and savers take place through the banking system. Even under conditions where bank charges are high, the banks role as financial intermediaries should still remain efficient in order to enhance well-functioning financial system in the economy. The banking sector system in the South African economy is highly concentrated and sophisticated with the five largest banks; namely Absa, First National Bank, Investec, Nedbank and Standard Bank. In absolute terms, these five banks account for between 70 percent and 90 percent of the market share of the banking industry's assets (Ojah, 2005).

The banking market has four distinct segments, namely the corporate banking segment, the personal banking segment, the asset financing (which encompasses, housing mortgages, vehicle financing and leasing) and the retail banking segment. The sector consists of a high concentration of corporate ownership with most of the large insurance and other non-bank financial institutions (NBFIs) being either controlled by banks or the NBFIs themselves having controlling interest in banks. This reveals both complexity and intensity of competition in the industry, which should therefore enhance efficient financial intermediation.

Banks therefore need to be efficiently fully engaged in financial service provision in a manner that embraces customers and at the same time avoiding emergence of disintermediation. This helps to ensure that banks remain serving as channels through which financial system consolidation realizes its full potential in curbing financial instability, and thus increasing the economic welfare of citizens (Ojah, 2005).

As part of the key focus area of this study, this study investigates whether bank charges, based on customers' perceptions, are a key determinant to bank/client relationship in the context of the South African economy. The rationale behind the study is to examine whether the respective banking industry is losing patronage and experiencing a general trend towards financial disintermediation due to high bank charges as well as increasing options for investing funds in alternative investments in other markets. Additionally, the study extends to examine whether it is substantially realistic that banks in South Africa seem to be discouraging a savings culture given the prevailing levels of bank charges or transaction fees charged to deposit and withdraw funds over customer accounts.

The fundamental question to be answered is whether bank charges impact negatively on bank/client rela-tionship. From this principal question follows the persistent disaggregated questions of the possible economic implications of bank charges for the banking industry and efficient leveraging of financial intermediation. It is against that background that the study therefore becomes imperative to understand whether bank charges are impacting on the way banks relate with clients which may in turn affect banks in their role as financial intermediaries.

Literature review

The literature on bank charges and their impact on client relationships remain subjective. According to Damme (1994), banks key roles are to mobilize financial resources, lend funds and facilitate payment services of financial transactions. They play a wide number of roles which include facilitation payments between customers by providing payment systems, transmission of monetary policy by acting as conduits through which central bank's monetary policy impact the financial sector, credit allocation to particular units of the economy, making investments more accessible to individual investors and issuing of financial claims (Saunders and Cornett, 2008).

It is therefore not avoidable for banks' behavior to impact either negatively or positively on people's lives. In the realization that the primary function of banks is to mobilize savings from surplus units and allocate these funds among competing users and deficit units on the basis of expected return and risk trade-offs, they therefore act as catalysts for economic growth (Pati and Shome, 2006). Thus failure by banks to efficiently execute this crucial intermediation role leads to far reaching repercussions on economic development as experienced by the global financial crisis of 2007-2008.

Levine (2002) concurs with the view that financing, both bank-based and market-based, is essential for economic growth and that financial development enhances efficiency in the allocation of scarcely available productive resources, thus stimulating the growth process.

In the study by Rajan and Zingales (1998), it was examined whether a link existed between financial development and economic growth, specifically investigating whether financial development facilitated economic growth by reducing the costs of transactions and external financing. The results from the study indicate that financial development influences economic growth through reduction of transaction and external financing costs. Under circumstances where intermediation is not efficiently achieved, the end-result becomes financial disintermediation. Financial disintermediation is a movement away from the intermediated provision of financial services via banks to direct financial relations

between lenders and borrowers. This reduces and eventually leads to the collapse of financial intermediaries in a financial system of an economy.

Though there may be many factors at play in shaping relationships between banks and their clients, the importance of bank charges and their perceived impact as an unnecessary cost cannot be ignored. The South African economy has an established, well regulated and sophisticated financial sector made up of banking; insurance and securities industries that are highly interdependent. Financial service providers comprise of banks, insurance companies, pension funds, unit trusts, fund managers, underwriters and investment banks (Hawkins, 2001).

In view of the above, a preceding research investigation was also conducted by Mpako (2007) on whether the significance of South African banks as financial service providers was declining (implying a move away from banks to other investment alternatives) based on growth and substitutability of bank deposits by money market mutual funds.

Money market unit trusts are specialized money market intermediaries that purchase money market instruments by pooling funds from investors to enable investors to earn high favorable yields from money market instruments comparative to deposits at banks. From the results, Mpako (2007) concluded that bank deposits as a ratio of total bank assets had been declining over the period 1997 to 2007, but mainly due to currency crisis as opposed to bank charges.

However, the research did not empirically validate whether disintermediation was taking place in the South African banking sector; although the regression relationships shown had provided as a strong tool for analyzing trends of bank deposits. The study focused specifically much on bank deposits and thus did not test whether the traditional intermediation role of banks was declining due to high alleged bank charges. Another preceding study on testing for bank disintermediation by Chetty (2011) was conducted and indicated that the role of South African banks as financial intermediaries was declining from an asset side perspective; coupled with a remarkable rise in the assets of NBFIs especially in terms of their share of bank deposits. The study concluded that disintermediation was taking place from the liabilities or bank deposit perspective; suggesting that banks were not actively sourcing deposits from surplus and facilitate transactions to deficit agents in an efficient manner. The study; however did not validate the extent to which such disintermediation was taking place.

From the broader financial perspective, it is imperative to consistently investigate other primary factors that influence bank/client relationships other than concentrating on the traditional approach of analyzing trends

of bank deposits. The banking services industry is characterised by high levels of credence and experiential features that make them difficult to be evaluated before consumption. Therefore, in order to minimize the risk and uncertainty related to the purchase of the banking service, customers consider a range of options that yield the highest possible return for their funds in form of bank charges, alternative investments and costs of switching from one bank or account to another in search of lower costs and high returns.

According to Jones et al. (2002), both bank charges and the costs associated with switching from one bank to another are principal factors influencing bank/client relationships. In that sense, a switching barrier is therefore any factor that makes it difficult or costly for customers to change providers of banking and financial intermediation services. A switching cost can also be regarded as the technical, financial or psychological factor which makes it difficult or expensive for a customer to change brand. When such costs are high for the customer, there is a greater probability that the customer will remain loyal in terms of repeated banking behavior because of the risk involved in switching between bank accounts.

1. Methodology

1.1. Survey questionnaire. A 5-point interval Likert scale was used to measure the respondents' perception on whether there is an association between bank charges and banks relationship with their clients.

The Likert scale examines how strongly respondents agree (5) (Strongly agree) or disagree (1) (Strongly disagree) with statements that measure variables in the hypotheses of the study. Finally, reliability and validity tests of the measures from the questionnaire are conducted to obtain reliable data that can be analyzed properly to reveal meaningful findings.

Sample and data collection:

A structured questionnaire was used to collect primary data on perceptions of respondents about the association of bank charges with the banks/client relationship. The selected respondents represent a reasonable sample size with a balanced mix of demographic factors; namely age, gender, education levels, employment status and income levels. A sample of 200 respondents was used to collect data for the analysis. The questionnaire was self-administered by the researcher.

2. Data analysis

The Chi-Square (χ^2) distribution test technique was applied to test for association between banks intermediation role and a range of respondents' perceptions on bank charges. The Statistical Package for Social Science (version 19) is used for the analysis. The raw data are first factor analyzed to summarize the sixteen variables into smaller sets of linear composites that

preserve most of the information in the original data set. The data are subjected to Principal Component Analysis to reduce components through varimax rotation. The factors to be used in the analysis are to be constructed based on Factor Analysis. Reliability test based on Cronbach's alpha is conducted from a total of sixteen factors. From the total of sixteen factors, seven are constructed and taken for analysis; described as follows.

♦ Relationship – Level of bank charges has adversely affected my relationship with my bank.
♦ Investment consideration – I am considering moving my money to other forms of investments because my money has been eroded away by bank charges.
♦ Mattress option – Given an option, I would keep my money under the mattress if bank charges remain too high.
♦ Other options of keeping money – The high levels of bank charges have influenced me to consider other options of keeping my money.
♦ Choice – The levels of bank charges have a bearing on the bank I choose to bank with.

♦ Charges determine future choice – In future, I will consider the level of bank charges before I choose a bank to bank with.
♦ Moving money – I will consider moving money from my current bank to another if I perceive my bank charges to be high.

3. Results and analysis

3.1. Descriptive statistics. From the descriptive analysis results presented (Table 1) below, the majority of respondents strongly agreed that the levels of bank charges have negatively affected their relationships with their banks and given an option, they would keep their money under mattress if bank charges remain high.

The majority of respondents also regarded bank charges as not an important determining their choices of the banks they can choose to bank with. Furthermore, most respondents strongly disagree that they can consider moving their money to other forms of investments purely because their money has been eroded away by bank charges.

Table 1. Descriptive statistics

		Relationship	Investments consideration	Mattress option	Other options of keeping money	Charges determine future choice	Choice	Moving money
N	Valid		133	133	133	133	133	133
Mean		4.45	2.60	3.51	3.24	2.88	3.06	.91
Std. error of mean		.079	.056	.124	.091	.083	.089	.025
Mode		5	3	5	3	2	3	1
Std. deviation		.917	.651	1.428	1.046	.954	1.028	.288
Variance		.840	.423	2.040	1.093	.910	1.057	.083
Skewness		-1.681	.118	-.467	.390	.670	.048	-2.893
Std. error of skewness		.210	.210	.210	.210	.210	.210	.210
Kurtosis		2.058	-.277	-1.183	-.856	-.273	-.406	6.468
Std. error of kurtosis		.417	.417	.417	.417	.417	.417	.417

With respect to distribution, results above indicate that most observations/values of investment consideration, other options of keeping money, charges determine future choice and choice are concentrated on the left side of the mean, with extreme values to the right; hence their distributions are right skewed. This is indicated by the skewness statistics of the respective constructs which are all greater than zero. On the other hand, most values of relationship, mattress option and moving money are concentrated on the right of the mean, with extreme values to the left; hence the distributions are left skewed. This is shown by skewness statistics that are all less than zero.

3.2. Factor analysis. The raw data collected were first analyzed using factor analysis technique with SPSS 19.0 (Green et al., 2000) to summarize the 16 variables into smaller sets of linear composites that preserved most of the information in the original data set. The data were subjected to principal component analysis, a method categorized under the broad area of factor analysis. The 16 variables were reduced to seven principal components through varimax rotation (Table 2). The seven factors emerged with no cross-construct loadings above 0.5; indicating good discriminant.

Table 2. Factor analysis – total variance explained

Component	Initial eigenvalues			Extraction sums of squared loadings			Rotation sums of squared loadings		
	Total	% of Variance	Cumulative %	Total	% of Variance	Cumulative %	Total	% of Variance	Cumulative %
1	2.083	13.021	13.021	2.083	13.021	13.021	1.795	11.222	11.222
2	1.528	9.551	22.571	1.528	9.551	22.571	1.510	9.437	20.659
3	1.365	8.532	31.103	1.365	8.532	31.103	1.402	8.762	29.421
4	1.354	8.462	39.565	1.354	8.462	39.565	1.361	8.504	37.924
5	1.268	7.926	47.492	1.268	7.926	47.492	1.333	8.334	46.258
6	1.246	7.785	55.277	1.246	7.785	55.277	1.296	8.099	54.358
7	1.112	6.950	62.228	1.112	6.950	62.228	1.259	7.870	62.228
8	.987	6.168	68.395						
9	.906	5.662	74.057						
10	.853	5.333	79.390						
11	.745	4.656	84.046						
12	.679	4.242	88.288						
13	.558	3.489	91.777						
14	.531	3.319	95.096						
15	.455	2.844	97.940						
16	.330	2.060	100.000						

Source: extraction method: principal component analysis.

3.3. External method validity. The data also demonstrated convergent validity with factor loadings exceeding 0.5 for each construct. Consequently, the results confirm that each of the selected seven constructs is uni-dimensional and factorially distinct; hence all items used to operationalize a particular construct are loaded onto a single factor.

From the results of the analysis, seven factors with eigenvalues greater than 1.0 were obtained and they accounted for 62.23% of the total variance. In the study, a pre-analysis testing for suitability of the entire sample for factor analysis was also applied.

Table 3. KMO and Bartlett's test

Kaiser-Meyer-Olkin measure of sampling adequacy.		.478
Bartlett's test of sphericity	Approx. Chi-square	217.711
	d.f	120
	Sig.	.000

As shown in Table 3, the Kaiser-Meyer-Olkin (KMO) measure of sampling adequacy is 0.478 and the Bartlett's test of sphericity 217.711, significant at $p <$ 0.000. This indicates that the sample used in the analysis is suitable for factor analytic procedures (Hair et al., 2006). Moreover, as the Chi-square test statistic is 217.112 (p-value = 0.000), the study identified that there was extremely low probability of obtaining this result (a value greater than or equal to the obtained value) if the null hypothesis (H_0) was true. The study assumed the null hypothesis (H_0) as the population correlation matrix of the measures is an identity matrix. Hence, the null hypothesis is rejected as the variables were correlated with each other.

3.4. Chi-square tests. The Chi-square non-parametric test of statistical significance for bivariate tabular analysis was applied to examine whether there is association between banks intermediation role and each of the variable explored in factor analysis above. The principal rationale and advantage associated with this technique is that it provides the degree of confidence to either accept or reject the null hypothesis of association between given variables.

Typically, the hypothesis tested with the Chi-square technique is whether or not two different samples are different enough in some characteristic or aspect of their behavior that can be generalized from the given samples that the populations from which the samples are drawn are also different in the behavior or characteristics.

From the results indicated in Table 4 lower, the hypothesis of association between differences in each of the variables defined and intermediation role is rejected for all constructs. The results: chi-square$_{(0.05; 4)}$ = 3.831, p = 0.429 for Relationship; Chi-square$_{(0.05; 4)}$ = 2.481, p = 0.648 for Choice; Chi-square$_{(0.05; 4)}$ = 6.596, p = 0.159 for Mattress option; Chi-square$_{(0.05; 1)}$ = 0.733, p = 0.392 for Money moving; Chi-square$_{(0.05; 3)}$ = 2.799, p = 0.424 for Investment consideration; Chi-square$_{(0.05; 4)}$ = 0.684, p = 0.953 for Charges determine future choice; and Chi-square$_{(0.05; 4)}$ = 2.698, p = 0.610 for Other options of keeping money, all suggest that

there is no statistically significant relationship between banks/client relationships and the construct-sidentified (customers perceptions on bank charges).

Table 4. Chi-square test results: intermediation role – (dependent variable)

Variable (construct)	Pearson's Chi-square value	d.f	Asymp. Sig (2-sided)	Decision
Relationship	3.831	4	0.429	Reject H_0
Choice	2.481	4	0.648	Reject H_0
Mattress option	6.596	4	0.159	Reject H_0
Moving money	0.733	1	0.392	Reject H_0
Investment consideration	2.799	3	0.424	Reject H_0
Charges determine future choice	0.684	4	0.953	Reject H_0
Other options of keeping money	2.698	4	0.610	Reject H_0

This implies that even if the level of bank charges has adversely affected customers' relationships with their respective banks and would therefore consider moving their money to other forms of investments and also keep their money under mattress due to erosion of the purchasing power of their funds, that does not imply that banks are losing customers due to perceived high bank charges. The empirical results therefore get us to the conclusion that bank charges are not a significant threat to banks intermediation role.

3.5. Symmetrical measures. The Cramer's V symmetrical measure technique has been applied to measure the extent of association or relationship between banks intermediation role and the variables used in the study analysis. The Cramer's has been applied for its fitness as a post-test that determine strengths of association after Chi-square has determined significance association between given variables. Cramer's V varies between 0 and 1; a value close to 0 shows weak association between variables while values close to 1 indicate strong association between given constructs.

Table 5. Cramer's V results

Variable (construct)	Cramer's V value	Asymp. Sig (2-sided)	Decision
Relationship	0.170	0.429	Very weak
Choice	0.137	0.648	Very weak
Mattress option	0.223	0.159	Very weak
Moving money	0.074	0.392	Very weak
Investment consideration	0.145	0.424	Very weak
Charges determine future choice	0.072	0.953	Very weak
Other options of keeping money	0.142	0.610	Very weak

Results presented in Table 5 above indicate very weak relationships between the variables used in the analysis and banks intermediation role. The Cramer's values results: $V = 0.170$ for Relationship; $V = 0.137$ for Choice; $V = 0.223$ for Mattress option; $V = 0.074$ for Money moving; $V = 0.145$ for Investment consideration; $V = 0.072$ for Charges determine future choice and $V = 0.142$ for Other options of keeping money, all suggest very weak relationships between banks intermediation role and the constructs identified (customers perceptions on bank charges). Thus, the Cramer's V results indicating very weak strength between banks intermediation role and the constructs identified support Chi-square results of no association in differences between the same variables under analysis.

Conclusion

Empirical results from this study did not find substantial statistical significance of any association between bank charges and banks/client relationship and therefore financial intermediation role. In the analysis rather, it was found that factors such as customers service and service experiences with their respective banks, alternative investments options, money keeping decisions and choice of bank; all being influenced by the level of bank charges, do not have a bearing on banks intermediation role in respect of customers' perceptions. This further suggests that if the banking sector is alleged to be experiencing diminishing trend in its role of financial intermediation, then it could significantly be due to some factors other than either bank charges themselves or customers' perceptions on bank charges. It is therefore against this background to conclude that banks in South Africa stand a great chance of advancing and playing an effective financial intermediation role that can contribute remarkably to economic growth and development, thus reducing unemployment and poverty levels in the economy.

In the further study around the same area, a different approach and methodology will be applied to

sufficiently explore and measure primary factors influencing banks financial intermediation role from a macroeconomic perspective. Non-structural methods of measuring concentration and competition levels in the banking sector will also be used to yield more insights on the relationship between banks conduct and their inter-mediation role.

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Appendix

Table 1. Communalities

	Initial	Extraction
Relationship	1.000	.648
Feeling	1.000	.447
Choice	1.000	.747
Moving money	1.000	.607
Mattress option	1.000	.633
Investments	1.000	.621
Investments consideration	1.000	.730
Institutions	1.000	.631
Banning bank charges	1.000	.276
Bank services outside South Africa	1.000	.781
Prefer cash basis	1.000	.543
Other options of keeping money	1.000	.691
Charges determine future choice	1.000	.764

Table 1 (cont.). Communalities

	Initial	Extraction
Intermediation role diminishing	1.000	.693
Should not charge us	1.000	.609
Banks play an important role hence I do not mind them charging me	1.000	.536

Table 2. Component matrix

	Component						
	1	2	3	4	5	6	7
Relationship	-.475	.557	-.182	-.009	-.148	.045	-.234
Feeling	.153	-.197	-.468	.339	.017	.067	-.215
Choice	-.346	.430	.001	.045	.198	.601	.200
Moving money	-.278	-.045	.183	.321	.132	.338	-.509
Mattress option	-.231	.288	-.576	.074	.266	.121	.272
Investments	.034	.496	-.132	-.457	-.267	-.266	.076
Investments consideration	.718	.242	-.081	-.125	-.219	.288	.042
Institutions	.444	.270	.305	.340	.289	-.258	-.042
Banning bank charges	.307	.272	-.127	-.151	.093	.128	-.208
Bank services outside South Africa	.661	.169	.068	.124	-.446	.309	.014
Prefer cash basis	.462	.035	-.103	.352	.401	.160	.090
Other options of keeping money	-.100	.268	.210	.487	-.086	-.389	.411
Charges determine future choice	.135	-.057	.270	-.431	.565	.169	.370
Intermediation role diminishing	-.239	-.308	.379	-.035	-.366	.451	.245
Should not charge us	.079	.230	.373	-.344	.275	-.077	-.459
Banks play an important role hence I do not mind them charging me	-.183	.452	.448	.291	-.104	.042	.016