THE NATURE AND EXTENT OF COMPETITION IN JAMAICA'S COMMERCIAL BANKING SECTOR: CONSUMER'S OBLIGATION TO THE COMPETITIVE PROCESS[1]

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Ladies and Gentlemen, Good Afternoon.

I am extremely grateful to Consumers International for inviting me to participate in this very important event, for being able to visit this beautiful island again; and for affording the Jamaica Fair Trading Commission the opportunity to share some of the preliminary results of our most recent study of the commercial banking sector in Jamaica. The study looks at fees and charges over the years 2005 to 2009; and the final report is scheduled for release by October 8, 2010.

There is little doubt that the proper functioning of a financial system is critically important to the prosperity of any economy. The need for a study of the Jamaican commercial banking sector was quite evident as for at least the past two years, the Jamaican public has been vociferously venting its disquiet with the conduct of commercial banks. Specifically, there is concern about the seemingly coordinated manner in which banks have been:

(i) introducing fees for services which were traditionally offered free of charge; and
(ii) increasing fees for services which traditionally attracted fees.

Put another way, consumers complain that banks are now charging for services which were once considered a part of their core function or the basic purpose for which they are set up. For example, they now have direct charges for making deposits to, and withdrawals from, savings accounts; from which they earn 'significant' income.

With commercial banks making triple-digit profit margins on these services, the public's perception is that the fees charged have resulted in consumers getting less than their fair share

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[2] It was prepared with the assistance of Miss Ann-Marie Grant, General Manager and Dr. Kevin Harriott, Competition Bureau Chief.

of the benefits generated by the market; and by extension there is serious concern regarding the extent to which banks are competing with each other.

To assess the validity of the perception, one must remain mindful that markets exist only because of the joint participation of consumers and suppliers. Consumers' share of the benefit, therefore, is as much the result of the actions of consumers as it is those of the commercial banks. For the public to realize the maximum benefits of competitive markets, consumers and suppliers have an obligation to behave in a manner which would allow for the competition process to prevail.

For the most part, the public is aware of the duties of suppliers to the competitive process, as is explicitly outlined in competition legislation enacted across the CARICOM region. This legislation prohibits suppliers, either individually or collectively, from engaging in conduct that would impede competition. Consumers have the duty to arm themselves with information that would allow them to compare similar services offered by the various suppliers.

Therefore, providing consumers with greater access to accurate, complete and timely information is crucial as it goes well beyond consumer protection. A more informed consumer base encourages healthy competition among suppliers and results in better service offerings as consumers, by way of comparative shopping, would be in a better position to avoid or switch away from suppliers who offer less affordable or inferior quality services.

In my presentation today I will discuss

(a) the structure of the commercial banking sector in Jamaica and highlight the implications of the structure on the conduct of the suppliers;

(b) the threat to competition in the sector, which necessarily flows from the lack of information on the part of consumers;

(c) and I will close by highlighting the preliminary recommendations which are geared at enhancing the competitive process of the sector, through better access to, and use of information by consumers.

Structure of the Sector

The structure of an industry is an important determinant of the likely intensity of competition. Industries in which any individual supplier has limited power to control prices are generally more competitive than those in which suppliers command such control. Market shares and the degree of inequality in size are indicators of how much power might be concentrated in one supplier or a group of suppliers acting jointly in a collusive manner.

In Jamaica, there are 7 commercial banks, five of which are either global or regional and the other 2 are local banks, with one being owned by foreign interests. In terms of deposits, assets and revenue, the two largest banks have a combined market share of over 75%. The third largest, is approximately one-fourth the size of the largest bank. In terms of branch network, 65% of all locations are controlled by the two largest banks; and these two banks are the only ones present in several geographic locations. This means that in some instances consumers' choice of banking services is limited to only those two banks. Our commercial banking sector can therefore be characterized as being highly concentrated.

It should be noted that in addition to the 7 commercial banks, there are 4 building societies, 3 merchant banks and over 50 credit unions. These institutions while not supplying the full slate of products as those offered by commercial banks do compete with the banks for a limited number of services. There are also other institutions such as cambios, and those that offer bill payment facilities that compete with banks in specific services.

Not withstanding the presence of non-bank institutions, there remains a significant threat to the competitive process given the structure and proliferation of retail banking services offered by commercial banks.

The banks' main income source is that from interest charges, which contributes over 60% (and in some cases almost 80%) to total revenue. Income from fees and charges represents between 15 to 20% of total revenue for the larger banks; and between 7 to 16 % of revenue for the 5 smaller banks. Since 2005, there has been a steady increase in the level of fees and charges. The difference between highest and the lowest average fees, in real terms, has increased significantly between 2005 and 2009. This is suggestive of a lessening of competitive constraints faced by the larger banks.

Threats to the Competitive Process

Broadly speaking, the main competition concerns are whether there is any individual bank abusing a dominant position in the market; and whether there is a group of banks colluding to restrict competition amongst themselves. Given that the market shares of the two largest banks are approximately equal, it is unlikely that any bank could be considered to be dominant, as contemplated by Jamaica's competition law.

Further, the concern regarding high prices being charged by banks and the introduction of new fees is unlikely to be considered an abusive conduct capable of lessening competition, since the charging of high prices does not prevent in any way rival firms from charging lower prices.

The possibility of collusive arrangements is a concern in Jamaica. Such arrangements generally include the coordinated setting of prices, the division of markets, or both practices. When suppliers collude they do not offer the lowest prices or best quality goods and services that they are capable of supplying.

Although discovering and successfully prosecuting collusive agreements is extremely difficult, and understandably so given the clandestine nature of the practice, identifying and assessing the factors facilitating this practice is fairly straightforward. The factors which are known to facilitate collusion include a small number of firms, comparable products, transparency and the opportunity to share information. Our review of the sector reveals the presence of the necessary factors that facilitate collusion. This is not to say however that the mere presence of those factors is evidence of collusion.

As alluded to earlier, there exists a considerable spread in the average fees charged by the players; and further this spread has widened over the period 2005 to 2009. This widening spread suggests that, among other things, the competitive constraints on the market leader has diminished over the period; and further, there might be opportunities for consumers to substantially reduce their expenditure on banking services by comparing the fees charged by the banks for a given service.

We are seeing where the spread associated with services and charges related to current accounts and bill payment services have increased; whereas the spread on services offered on savings accounts has decreased.

A few of the relevant questions are:

- Are there other factors that could explain the seemingly lack of competition among banks?
- Do consumers have the necessary information to make decisions regarding their consumption of banking services?
- Are banks providing relevant information?
- Are consumers seeking relevant information?
- Should there be an oversight body that among other things, ensures that the relevant information is placed in the public domain and reviews contract terms and conditions that could be considered as being unfair?

It seems reasonable to expect that a rational consumer would gather information about prices only if the expected benefit of that exercise, in terms of discovering lower fees, exceeds the costs involved in such an effort. The cost of this effort comprises costs relating to information acquisition and those relating to "switching" from a higher fee bank to a lower fee one. But if consumers perceive that all banks are charging high prices, what would be their incentive to search for information?

We have noted that the acquisition of relevant information can be burdensome for individual consumers. Banks can and do change their fee structure at varying times in a year; and some times without notice. This makes it potentially difficult for comparative shopping; and it is somewhat of a 'bothering' task for consumers.

The orderly dissemination of information is therefore of critical importance to the smooth functioning of the market. When information is disseminated orderly, in the sense of being released at predictable intervals – and of course not necessarily by the banks – then the cost of keeping informed would be lower for consumers. The informed consumer facilitates competition among rivals, who may not have the incentive to provide complete information to consumers.

In 2005, the FTC completed its market study on the petroleum sector and a code of conduct for use by petroleum marketing companies. Included in the code of conduct was that marketing companies post the prices of each type of gasoline on the display boards of all gas stations; as this would serve to inform consumers of their options. The FTC suggested that this be made a requirement and encoded into legislation. It was decided that, instead, we should persuade or encourage the marketing companies to post their prices. After about a year of discussions, only a few gas stations posted their prices and the few that did, did not do so consistently.

Luckily for our market, there was a relatively new entrant, working hard to gain market share; and this new entrant began displaying their prices and offering low prices and 'specials' at several key geographical locations. They started to have long lines of consumers patiently waiting to be served; and shortly thereafter, their competitors started offering lower prices and posting their prices. Now, five years later, all gas stations post their prices on display boards, and several offer 'specials', which are advertised, from time to time. Further, it is now established that prices are lowest in geographical areas in which two or more marketing companies compete.

So what can be done to facilitate the flow of relevant information to consumers in the banking sector?

Preliminary Recommendations

Our recommendations at this time relate essentially to (i) the mandatory (or voluntary) provision of information by banks to consumers and their customers; and (ii) effective and continuous consumer education programs. Specifically, for all services offered by banks, the price must be stated before the service is provided so that consumers can decide whether or not to proceed with the transaction. Also, for all penalties or charges, for example minimum balance violation fee, information should be provided as to how consumers may avoid such charges, where possible.

We note also, that given the structure of the industry, consumer choices may be limited and in several instances they are unlikely to avoid prices that may be considered excessive. For example, where a consumer is desirous of a service which only his bank is able to provide, like a letter of reference.

It is generally accepted that for competition to take hold in any market, consumers need to be informed; and therefore, an important element in the competitiveness of any industry is the reaction of consumers to changes in prices. Therefore, if banks are to have the proper incentives to offer their services under reasonable terms, then it is necessary for consumers to be adequately informed about the services and the terms under which they are being offered.

"A highly competitive financial sector, appropriately regulated … will be more conducive to positive future economic outcomes than a non-competitive or weakly competitive financial sector." - *International Competition Network*

In closing, I say, for the maximum benefit of competition to be realized for an economy, all consumers and suppliers have an obligation to behave in a manner which would facilitate the competitive process. Competition authorities and consumer protection advocates must provide the support which allows for the process of competition to take root and to flourish.

Thank You.