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Discussion Paper

Is there a deficit of consumer trust in the financial sector? If so, what concrete measures can be implemented to remedy this?

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1. Introduction and Background

Following the global financial crisis (GFC) of 2008 there has been much discussion regarding client and community based trust in the banking and finance sector. Indeed, one of the widely reported outcomes of the GFC was a fall in confidence of the banking and financial services sectors within our economies. The crisis itself has been named as a crisis in trust. The fragile global economy, the subprime lending crisis in the USA, austerity and bailouts in the European Community and governments issuing deposit guarantees have all coincided with a reported fall in bank related trust. The Edelman Trust Barometer has seen trust in the financial sector globally among the lowest of all sectors it monitors, although some improvement in trust has been seen in recent years.[1] By International comparison Australia has low levels of trust with less that 50% of survey populations typically reporting that they trust the sector. This is particularly interesting, in as much as the Australian Banks have not been without scandal, the shocks that that rippled through other western countries have in general been much larger. Interestingly, we are now a number year's out from the GFC, but societal trust in the banking and finance sector has failed to recover. While trust barometers are an important instrument, univariate analysis is problematic as it offers little explanation as to the drives of trust. This project will track the pattern of trust within Australia from 2003 to 2014 and then examine the determinants of trust in banks at the consumer level of analysis. This allows us to provide a detailed picture of the drivers of the largely mistrustful Australian population in relation to the banking and financial service sector.

This project will investigate a set of possible drivers that relate to an individual's characteristics, political persuasions and beliefs about debt and financial management, as well as social factors. The banking and finance sector, along with policymakers are faced with the challenge of building and maintain trust in this sector but cannot do so while they remain uninformed in terms of the determinants of these perceptions. To date, the sectors response has been to deal with the issue from a compliance perspective but the current research on trust suggests that it is a much more complex construct. Further, it is essential to better understand drivers of trust as it is important for the efficient functioning of our financial institutions, leading to economic growth. When trust/confidence is present, transactions costs are lower,

[1] See: http://www.edelman.com/insights/intellectual-property/2016-edelman-trust-barometer/state-of-trust/trust-in-financial-services-trust-rebound accessed on 11/11/2016.

organisations function better, and financial development is faster, more effective and more efficient (Knack and Keefer ,1997 and Guiso, Sapienza and Zingales, 2004).

2. Project Data and Methodology

The project will track confidence the Australian banks and the determinants of this confidence, through time, using the Australian Survey of Social Attitudes (ASA) data. The Australian Survey of Social Attitudes is a biennial survey which began in 2003 and is a primary source of data for information on social attitudes, beliefs and opinions. It is designed to track changing attitudes through time but is not a longitudinal (panel) dataset. A different sample of the Australian population is surveyed each time and while there are a set of core questions the survey changes through time as society and social issues change. Confidence in banks has been asked in 2003, 2005, 2009, 2011 and 2014 as gives us an interesting picture of trust both before and after the GFC. The data also contains information on confidence in major companies for the same period of time which offers an interesting point of comparison.

We, therefore, have two variables of interest i) confidence in the banks and ii) confidence in large Australian companies. Moreover, each respondent answers both these questions. The statistical model employed needs to account for three characteristics of the data. Firstly, the dependant variables are discreet and ordered in nature, taking values from 1 to 4 and increasing in the level of implied confidence. Secondly, we expect that individual demographics, financial position and attitudes towards debt etc. will be important in explaining variations in an individual's probability of recording any level of trust in the banking sector. Thirdly, we wish to allow for unobservable individual-specific factors that determine confidence/trust. In essence, the unobservable individual-specific characteristics that impact on trust in banks are likely to be correlated with those that impact on trust in large companies. Therefore, as well as single equation modelling we will adopt a seemingly unrelated bivariate ordered probit model (a two equation ordered probit model).

Adopting a latent variable framework we assume two latent: variables bank confidence y_1^* and large company confidence y_2^* determined by:

$$\begin{aligned} y_1^* &= X_{1i}^{'}\beta_1 + \varepsilon_{1i} \\ y_2^* &= X_{2i}^{'}\beta_2 + \varepsilon_{2i} \end{aligned} \tag{1}$$

Where β_1 and β_2 are vectors of unknown parameters and X is the set of variables thought to determine confidence in banks and confidence in large companies. ε_1 and ε_2 are error terms distributed as bivariate standard normal with correlation ρ and the X variables are assumed to satisfy the exogeneity conditions such that, $E(X_{1i}, \varepsilon_{1i}) = 0$ and likewise $E(X_{2i}, \varepsilon_{2i}) = 0$. This model can be estimated by maximum likelihood and it should be noted that if the error correlation $\rho = 0$ the model collapses to two separate ordered probit models for y_1 an y_2.

The findings from this project will allow the banking and finance sector, and regulators/policy makers to better understand the drivers of confidence and so make improved (evidence-based) decisions in terms the strategies they employ to rebuild consumer confidence in Australia's banks.

References

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