Gartner

Industry Research

Publication Date: 7 August 2008 ID Number: G00160179

Organizing for Innovation in Financial Institutions

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Financial services firms struggle with the concept of innovation. Many try project-based initiatives, but few establish the organizational constructs that enable innovation to be sustained and integrated with the strategic goals of the enterprise. Discussions with Gartner clients highlighted some valuable approaches to developing an innovation strategy.

Key Findings

- In a global Gartner survey on innovation in financial services, 50% of the respondents did not have a formal process for innovation.
- Sixty-one percent of survey respondents had no standing budget to fund innovation.
- The creation of an innovation culture is essential to enabling organic growth.
- Creating a systematic methodology for tracking disruptive technologies, market trends and discontinuities is essential in meeting competitive challenges.

Recommendations

- Challenge incumbent bureaucracies and protected institutions. Innovation comes from doing the illogical, experimentation, testing and even failure.
- Make innovation central to the enterprise strategy of organic growth. Ensure that innovation is a strategic priority that is relentlessly discussed and pursued by the board of directors and all layers of management.
- Develop a culture of innovation that embeds the process and opportunity for innovation into the DNA of employee workflow.
- Make innovation strategy inclusive for all employees as well as for third-party stakeholders, partners and customers. Establish an innovation team that acts as a catalyst for creativity.
- Develop an innovation structure that facilitates the identification and management of idea flow — reward successes, expect and manage failures.
- Ensure that the innovation strategy is sustainable by setting aside formal funding of initiatives on an ongoing basis, regardless of economic conditions. The best ideas often come in moments of extreme organizational stress.

ANALYSIS

Introduction

The numbers are striking. A McKinsey analysis of top U.S. banks found that from 1999 through 2006, mergers and acquisitions contributed 62% of their overall growth. However, organic share growth *declined* by 16%. In Europe, the picture is remarkably similar.

However, especially outside the financial services industry, global innovators make organic growth a central tenet of their growth strategies. McKinsey's data suggests that organic growth added 25% of total growth for leading consumer companies and 13% for the fastest-growing global organizations (see http://www.bai.org/bankingstrategies/2008-may-june/Innovation-Growth/).

In banks, McKinsey analyzed the share prices of some of the top retail banks in the U.S. through 2007 and found that, on average, 91% of a bank's value is based on current earnings. Only 9% is related to the expected value of future growth. In contrast — and perhaps at the opposite extreme — 69% of Apple's share price represents the value of future growth.

Analysis

As many financial services firms wrestle with trying to increase top-line growth organically, they are talking to Gartner about innovation as the catalyst. The goal is to try and break free from a competitive landscape fraught with liquidity problems, compliance issues, product similarity, customer fickleness and a host of other challenges. The belief among financial services providers (FSPs) is that innovation will potentially create new markets, products, services and business models, or at least drive efficiency in existing markets that will enhance share price/performance.

However, many of our clients struggle with how to achieve and sustain innovation. A July 2008 Gartner study on innovation in financial services firms reveals that only 50% of global respondents have a formal process for innovation. McKinsey's data indicates 40% lack any organizational mechanism dedicated to facilitating innovation.

While there is no prescribed methodology, discussions with several of Gartner's financial institution clients reveal a standard set of cultural and operational pointers, as well as work practices that can help firms develop an approach to innovation. This research provides responses to questions from our clients, such as:

- Should financial services firms create a defined innovation organization (similar to the e-business teams of the late 1990s)?
- What role should innovation teams have?
- How is innovation funded?

Note that 61% of respondents to the Gartner survey say they had no standing budget to fund innovation. Twenty-seven percent of the respondents said there was no process in place to ensure that innovation ideas were aligned to enterprise strategic goals or the business initiatives that will drive most organic growth.

This research also highlights some of the critical considerations for developing an innovation strategy.

1. Develop an Enterprise Strategy

Financial services firms should start with an enterprise mandate that is based on a corporate philosophy of innovating everywhere. There is no point in a fragmented approach that "cherry picks" certain aspects of operations. The interrelationship between business layers, data, process, risk management and so on would make such isolated innovation initiatives a waste of time.

To cement the enterprise approach, it may make sense to include innovation as one of the enterprise's macrostrategic themes. This ensures appropriate visibility and, thereby, continued organizational support. Enterprise engagement also helps address the thorny issue of protected institutions. Any and all operational/business activities must be considered ripe for fresh approaches.

2. Create Cultural Compatibility

Cultural compatibility engenders the notion of a cultural work environment that actively promotes the tenet that every employee can innovate and will be rewarded for it. More often than not (sometimes as the result of a "hangover" from e-business initiatives), there is a sense that only certain people have good ideas. Or a particular role or someone's standing in the FSP may be seen as denoting innovative expertise. These are false assumptions.

Successful innovative programs used by clients we have spoken to focus on inclusiveness and accountability based on a shared strategic mission, goals, and values. These programs are highly collaborative and participatory, regardless of the position, rank, role or perhaps even the deep-domain expertise of participants. Indeed, most FSP organizational structures directly impede the very nature of innovative activity.

Innovation often stems from illogical thought processes for which precedents and tested solutions may not exist, despite coffee-table-book-sized project plans and approval processes. Creating an environment and providing the time for experimentation, test and failure — the outcomes of which may be uncertain and which may not be easily calculated using standard returns on investment (ROIs) — is essential. Such a policy doesn't need to be as structured as Google's, which sets aside 20% of employee time for innovation. However, it could be a continual process in the context of existing job roles, provided those roles do not directly prevent idea generation.

Innovation programs in traditional bureaucratic hierarchies will not survive. Senior leadership must ensure that cultural compatibility fosters creativity, entrepreneurship, networking and (within reason) rule breaking. FSPs must be able to balance — organizationally — the demands of structured processes (for example, because of regulatory or risk management constraints and, at the other extreme, the potential chaos that fosters the creative process).

HR should have processes in place that actively promote collaboration of individuals and teams across geographic regions and business domains, including employee transfers, and allowing for input from third-party stakeholders (for example, technology vendors, customers and partners). A core tenant of HR policy must be open and effective communication and a "no fear" environment in which employees should not feel constrained by the potential of failure while also being recognized and rewarded for innovative ideas that create value for the company.

Most financial services firms have organizational structures that inhibit participation or collaboration.. Senior-level executives, therefore, may be called on to implement a change management program simultaneously with any innovation initiative. This can be changed by tackling specific business challenges/opportunities and rewarding employees directly for involvement in the innovation process. An idea pipeline should be tied to the business goals and monitored on a regular basis to ensure continued correlation.

In Google's case, a corporatewide suggestion box captures ideas posted by any employee on any subject. Software then enables these ideas to be discussed and ranked in the form of a prediction market, using wisdom-of-crowds theory principles. Understand that the creation of an innovation culture is a journey with no defined timeline. However, the journey should ultimately link to improvements in long-term shareholder value and will require a sustained enterprise effort.

3. Appoint a Coach, Not a Manager

A senior executive needs responsibility for program coordination, project measurement, collaboration and prioritization, and any transformation strategy. Executives must be able to clearly articulate a shared understanding of what innovation means to the organization and how it relates to organizational (and employee) goals.

This is not strictly a management role, but rather that of a coach. This is critical, because coaches inspire rather than correct, and this can encourage employees to give their best rather than to do just what they have to. Look for leaders of innovation programs who can: ask any question; actively listen; is an optimist; can leave their egos at the door; are responsible risk takers; and can relate to people at a personal level. Innovation leaders do not look for the "quick fix," but seek to build a body of understanding that can transform the organization and, thereby, the competitive environment.

Planners should ensure that the coach reports directly to the CEO. Establish quarterly reporting for the overall program and its initiatives to the CEO and the board.

4. Keep the Innovation Team "Lean and Mean"

Establish a core innovation program team and keep it light and nimble — 10 people or fewer for a midsize-to-large firm. (Most firms still lack any kind of formal innovation council/team.) Teams should be cross-functional, so ensure that there is a good blend of experience and a diversity of backgrounds (for example, analysts, entrepreneurs, HR, marketers, bankers, IT specialists and so on).

The team should be responsible for idea identification, prioritization (based on the financial institution's strategic imperatives), incubation (to validate the business case and ensure that no work is undertaken without the prior sponsorship and commitment from a business unit), promotion, support and coordination. During the initial stages, simple Microsoft Office tools can be used to manage these activities; however, at some point, it is likely that more-sophisticated ideation management, social computing, innovation ranking and scoring software will be beneficial.

The innovation program team should also be responsible for beta development (in conjunction with the idea generators), testing and eventual rollout to the specific business units, as well as offering guidance and support with respect to scalability. This basically involves managing the infrastructure to innovate and, in the word of one innovation program manager, "just trying stuff." Team members should *not* be considered the font of all innovation or the only ones to innovate in the firm or control or dominate the process.

5. Create Infrastructural Freedom

Ensure that the innovation program team has the capability to operate "off the network" under strong policy guidelines. This will mean team members have their own infrastructures and IT capabilities that map to existing bank infrastructures but are not impeded by normal security restrictions, such as firewalls, gaming ports and so on.

6. Ensure Innovation Funding Is Treated Like the CEO's Bonus (It's *Sacrosanct*)

Fund the innovation/transformation program separately from operational budgets. There will be a requirement for initial seed funding for an innovation program. Establishing a balance sheet line item ensures enterprise visibility, assigns responsibility and creates accountability.

Initial funding does not have to be substantial, but it should be sufficient to ensure the provision of dedicated IT infrastructure and resources. Specific amounts will vary by institution type and size, as well as the strategic intent. Ensure that the funding comes directly from the CEO or similar "C-level" executive, and ensure that the program is established with sustainability, regardless of executive tenure. This may be possible via the establishment of an innovation executive council that also controls enterprise funding and is made up of senior business leaders.

7. Build an Innovation Network

Engage third parties to provide ideas, checks and balances, scalability assessments, technical viability, and so on. Be very careful to prevent vested interests from derailing initiatives. To mitigate this risk, ensure that the network of contributors is large enough to facilitate multiple contributions. Third-party involvement should include universities, technology vendors, consultants *and* customers.

Create a defined process to manage the interactions, including feedback loops. Ideas should be collected by and fed into the idea management process or ideation tools. The network must be kept dynamic and energized via constant communication and interaction, or it will not provide effective input. Ensure that there is sufficient two-way communication and that contributors can garner benefits from their continued involvement.

8. Create Friendly Competition

Establish an innovation competition (see "Case Study: Turkish Bank TEB Builds a Culture to Promote Innovation"). This can also be among clients or other groups, such as university students. Students could be given a particular "real world" challenge that the institution is facing, (for example, how to create a social lending platform). Students can provide and potentially beta develop the ideas.

One Canadian bank, RBC, offers a $20,000 prize for the winner in such a program. This bank owns the intellectual property and is working on allowing customers to vote on which idea would be developed by the bank, as opposed to bank executives making the decision. As an extra incentive, the bank selected six students to start blogs directly on the RBC Web site, discussing financial services matters that affect the students' generation. One of the ideas from this competition program produced the RBC peer-to-peer Web site.

9. Set Up an Innovation "Radar"

Create a systematic methodology for tracking external developments. This radar must be able to scan financial services *and* other industries for examples of innovation (trends, disruptive technologies and discontinuities), thereby capturing a set of robust of information that can be used to sustain a learning-oriented organization. It may be appropriate to assign parts of geographic regions or specific industries to individuals in the team to manage the collection and analysis of data before sharing within the group.

Alternatively, this research and analysis role could be assigned to a specific member of the team — a "radar operator." It is essential that ideas and analysis concentrate on applied innovations and steer clear of "think tank" initiatives. Specifically, differentiation must be made between competitive initiatives that have been significantly hyped, such as social lending, mobile payments and so on, and those initiatives that have immediate and quantifiable business return.

Any and all sources of information should be monitored, including blogs, podcasts, conferences, professional analyst and consultancy firms, industry forums, universities, specific social networks and so on. Innovation teams should act as catalysts in line-of-business meetings as well as proactively facilitating forums or discussions to refine, reprioritize and potentially re-engineer specific projects based on what the radar is telling them. The radar operation is a mission-critical activity that should prevent the financial institution from being surprised by external events, competitive threats and so on.

Recommendations

- Challenge incumbent bureaucracies and "sacred cows." Innovation comes from doing the illogical, experimentation, testing and even failure.
- Make innovation central to the enterprise strategy of organic growth. Ensure that innovation is a strategic priority that is relentlessly discussed and pursued by the board of directors and all layers of management.
- Develop a culture of innovation that embeds the process and opportunity for innovation into the DNA of employee workflow.
- Make innovation strategy inclusive for all employees as well as for third-party stakeholders, partners and customers. Establish an innovation team that acts as a catalyst for creativity.
- Develop an innovation structure that facilitates the identification and management of idea flow — reward successes, expect and manage failures.
- Ensure that the innovation strategy is sustainable by setting aside formal funding of initiatives on an ongoing basis, regardless of economic conditions. The best ideas often come in moments of extreme organizational stress.

RECOMMENDED READING

"The Innovation Culture: Definition and Critical Success Factors"

"Case Study: Turkish Bank TEB Builds a Culture to Promote Innovation"

"Case Study: Pacific Northwest Bank Innovates the Branch of the Future"

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