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Financial services industry's [1] innovation management practices. What's working?

September 1, 2019

Overview

CIO recently analyzed information from our on-line survey data base relating to those respondents who state that they are in the financial services industry.

Innovation in the financial industry can be controversial. Too much of the wrong kind of innovation precipitated the economic collapse in 2008. On the other hand, financial institutions continue to introduce new services, new products, and spend a fortune keeping the back office up to date with new IT developments. Acquisitions, mergers and restructurings abound – at least in some countries. Fintech is moving into many banking areas once regarded as sacrosanct for the financial industry.

One of the responsibilities of leadership[2] is 'create an inclusive environment in which all employees are encouraged to be innovative and share ideas. Is this happening? How does management do this? What management practices should be adopted to bring about innovation?

A perspective on what takes place in the industry is provided by Michael Blum when he was asked[3] whether there was any space in banking for innovation.

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> *'Absolutely! There is a lot of space for innovation, although in many banks conservatism starts to dominate again when the moment comes to implementing it.' On the one side, you frequently have people with great ideas, but who don't know how to turn them into real business. On the other side, some good ideas never happen because there is no execution capability. We often see this in history. In other cases, there are great ideas, but they won't make any money.*

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[1] Banking, finance, real estate and insurance
[2] Securities Industry and Financial Markets Association (SIFMA) web site, May 14, 2013
[3] http://www.imd.org/news/Banking-executive-underscores-importance-of-innovation-in-the-financial-services-industry.cfm, March 19, 2013

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The message is that there are lots of ideas within the industry but the problem is implementation. ‘It’, meaning innovation, does not happen as often or as fast as it should. Why?

In this paper CIO, by making use of information drawn from the on-line survey, identifies management practices which support or discourage innovation in the financial services industry. To quote; ‘Traditional approaches[4] to strategy (in the banking industry) are proving to be inadequate to deal with fundamental changes. Leaders must develop a set of new management practices if they want to survive and succeed in the open innovation paradigm’.

Which innovation management practices make most sense if management seeks to encourage innovation and entrepreneurship?

Observations regarding on-line survey results

On-line survey results tell us.

- Sixty percent of respondents say their organization does not have a tradition of innovation (F#22), despite a call from management for more innovation (F#2).

- There is an overall decline in innovation (F#24) amongst the companies for which respondents work.

Part of the problem may well be the focus on short-term versus long-term profits (F#1) and that innovators leave the organization (F#21).

Clues to the slow adoption of innovation may lie in the differences expressed by those in the financial services industry when compared to results from overall registrants. In the financial services industry, there is;

- limited tolerance for failure (F#5)
- little recognition of or rewards for innovators (F#7),
- not much room for working outside of the corporate norm box (F#8),
- little risk assumed in the planning process (F#9)
- too much hierarchy (F#18), and
- insufficient staff involvement in decision making (F#20) confirming the lack of decentralization.

These differences, as illustrated in the table in the Appendix B. ‘Comparison of ‘Ideal’ as between overall respondents and those in the financial industry’, are significantly different and taken account of in any subsequent analysis.

[4] http://en.wikipedia.org/wiki/Open_innovation_in_financial_services

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The conclusions reached seem supported by external sources.

- According to Fasnacht[5], there is a need for a much more intrapreneurial attitude as well as ‘ambidextrous’ thinking in order to initiate innovation. Entrepreneurs typically require both recognition and rewards of either a monetary or non-monetary form.

- Often, ideas abound in an organization but there is a major difficulty, because of the culture, in surfacing ideas and eventually becoming a business[6]. Highly innovative companies which CIO has researched have a culture which is reinforced by management practices designed to build and sustain innovation.

- According to a report[7], the elephant in the room – in the financial industries room – is the culture of the organization, which is supposed to, but may not. provide support for innovation. The same report provides a list of initiatives being taken by at least one financial institution to improve communication and collaboration; a clear recognition of the current barriers to innovation found in large financial organizations.

CIO’s report provides insights into the nature of this culture and points out the need for each organization to better understand its own culture before embarking on any program to improve innovativeness. The ‘elephant’ needs to be better articulated prior to taking corrective action!

A further break out of survey results is provided in Appendix C where Factors are segmented into three major topics.

1. Leadership,
2. Organization and management of day-to-day operations,
3. Idea generation and realization.

CIO has developed a higher-level benchmark[8] for purposes of comparing company results. This benchmark, a collage drawn from researching three highly innovative companies (P&G, John Deere, and 3M), is called the ‘BofB’ or the Best of Breed.

The summary, set out in Appendix C, provides a summary of conclusions drawn from a comparison with the ‘BofB’ benchmark.

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[5] http://en.wikipedia.org/wiki/Open_innovation_in_financial_services
[6] Banking executive underscores importance of innovation in the financial services industry. An interview with IMD alumnus Michael Blum
[7] Innovation and Knowledge Flow in the Financial Services and ICT Sectors of the Toronto Region, November, 2011. Wolfe, Davis, Hepburn, Mills, Moore. Prepared for the Ontario Ministry of Research and Innovation, the Toronto Region Research Alliance, and the City of Toronto.
[8] For more information on the Best of the Best benchmark, please visit the web site; http://www.corporateinnovationonline.com

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Level of dissatisfaction

The level of dissatisfaction amongst respondents from the financial services industry, is measured by those Factors which have the largest difference between the respondent's 'Ideal' and their 'Reality'.

- Factor #3; the lack of tolerance for mavericks. Mavericks are encouraged in highly innovative companies.
- Factor #4; planning emphasis is seen to be focused upon cost reduction rather than on identifying opportunities.
- Factor #7; career and recognition of innovators. Not much is done.
- Factor #8; little tolerance for 'things' outside the corporate norm.
- Factor #10; the form of intra-firm communications, where the preference is for informality and not formality.
- Factor #12; dealing with the issue of hierarchy and decentralization. Its minimization is highly desirable.
- Factor #13; decision process is too elaborate.
- Factor #14; rewards for innovators. Not much is done.
- Factor #18; the organization has too much hierarchy.
- Factor #19; whether there is a sense that resources are or would be available should beneficial projects be identified. The sense is that there would not be resources available.

Thus, ten Factors represent barriers to instilling entrepreneurship and innovation in the financial industry. The problem areas are, in this case, better defined. The 'elephant' in the room becomes more articulated! Options for taking action to improve the situation can therefore be better targeted.

Conclusion. What seems clear from the analysis is that there is an on-going major concern about how innovation is rewarded and perhaps regarded in the financial industry. If respondents were drawn from the investment banking side of the business – risk taking –, the concern seems poorly placed, given typical compensation levels for the investment group. The implication is that the majority of respondents are from other than the investment group. CIO's on-line survey does not differentiate. Typically, one understands that the non-investment banking side of financial institutions is somewhat bureaucratic, highly centralized, and communications are made more difficult due to the size of the organizations.

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Appendix A

Methodology

Respondents to the on-line survey are asked for their opinion on what would be, for them, an 'Ideal' situation; i.e. what in their view characterizes the best management practices for encouraging innovation. Respondents provided their rating of an 'Ideal' situation for each of 25 Factors.

In this paper the on-line survey results are divided into two groups; those engaged in the financial services industry and all other survey registrants. The purpose of making the comparison is to ascertain whether there were major differences in the views held by those in the financial industry as compared to the views of all respondents.

Additionally, respondents provided their opinion on their 'Reality' for each 25 Factors. The difference between the 'Ideal' and their 'Reality' is a measure of their satisfaction with their organizational and management arrangements.

Lastly, CIO compared respondents' results with CIO's Best of Breed benchmark for measuring best management practices impacting innovation.

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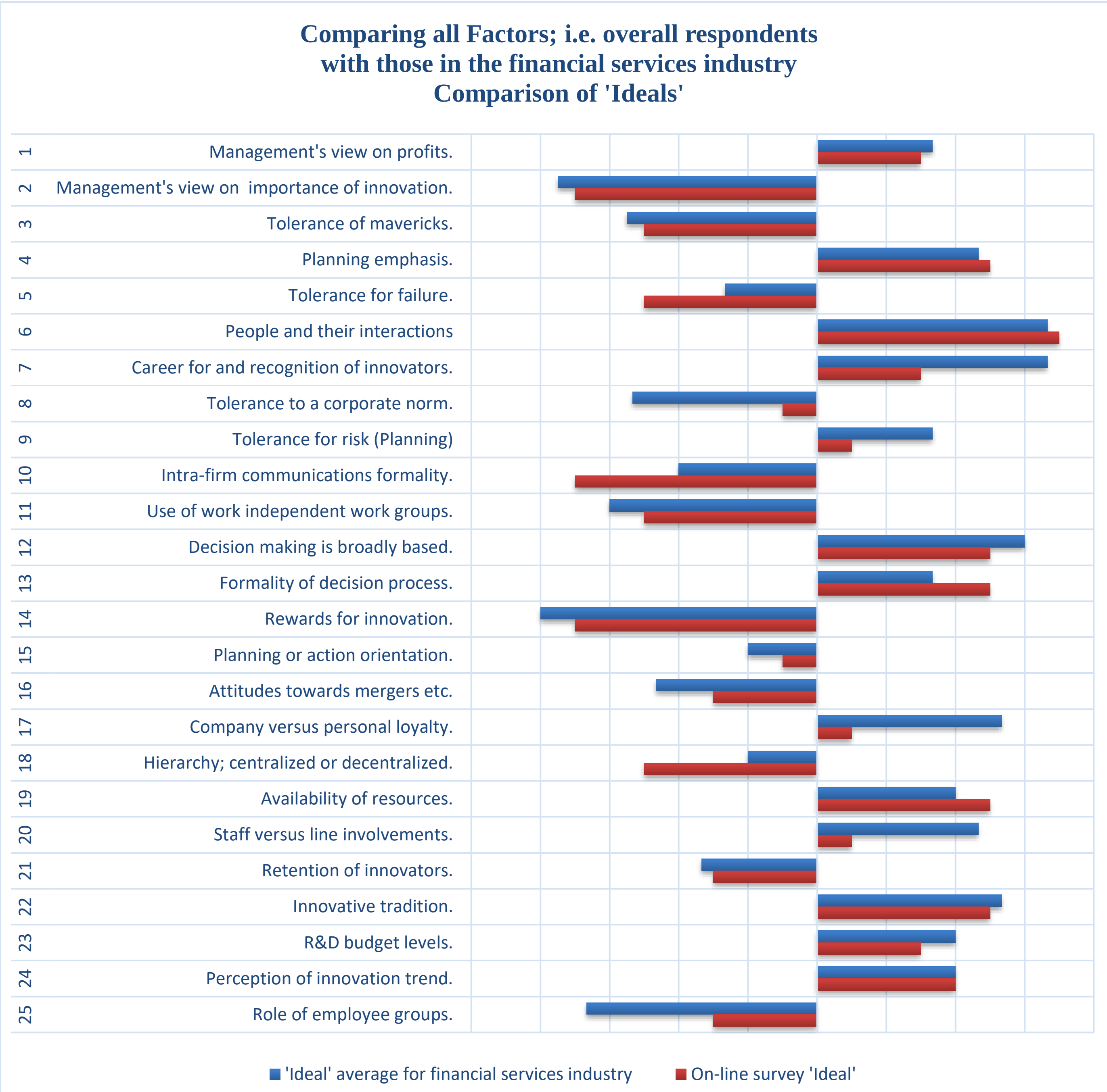
Appendix B

‘Ideal’ management practices
Financial industry registrants compared to all registrants?



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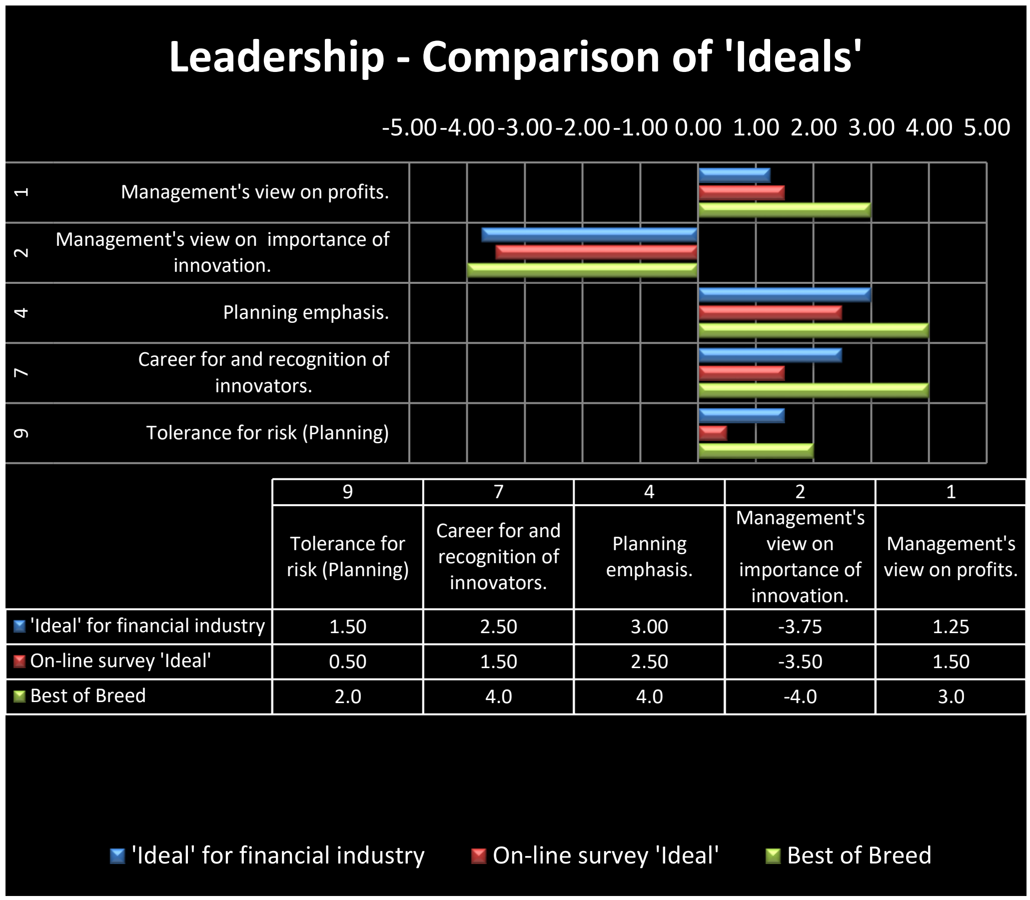
Appendix C

Survey results broken out by topic; 1. leadership, 2. organization and management of day-to-day operations and 3. idea generation and realization

1. Leadership

CIO has isolated 5 Factors which come under the theme of 'Leadership' and provide a comparison of all three 'Ideals' under this theme.

The inclusion of the BofB benchmark suggests that the leadership of highly innovative companies – those researched by CIO - places much greater emphasis on two Factors than is the 'Ideal' derived from on-line survey data. Management has a longer-term view on the importance of profits. The provision of careers and recognition of innovators is highly important. This finding is especially relevant to the financial services industry as management attempts to improve innovation. Leadership is the key to innovation.



	9	7	4	2	1
	Tolerance for risk (Planning)	Career for and recognition of innovators.	Planning emphasis.	Management's view on importance of innovation.	Management's view on profits.
'Ideal' for financial industry	1.50	2.50	3.00	-3.75	1.25
On-line survey 'Ideal'	0.50	1.50	2.50	-3.50	1.50
Best of Breed	2.0	4.0	4.0	-4.0	3.0

Summary

Highly innovative companies (the BofB) place slightly more importance on profits over the long term than do all respondents and those in the financial industry. Innovation is ranked as important by all three groups. Highly innovative companies place more emphasis on finding opportunities and less on cost reduction than the other two groups. Career and recognition for innovators is highest for the highly innovative companies as is their tolerance for risk when compared to other two groups.

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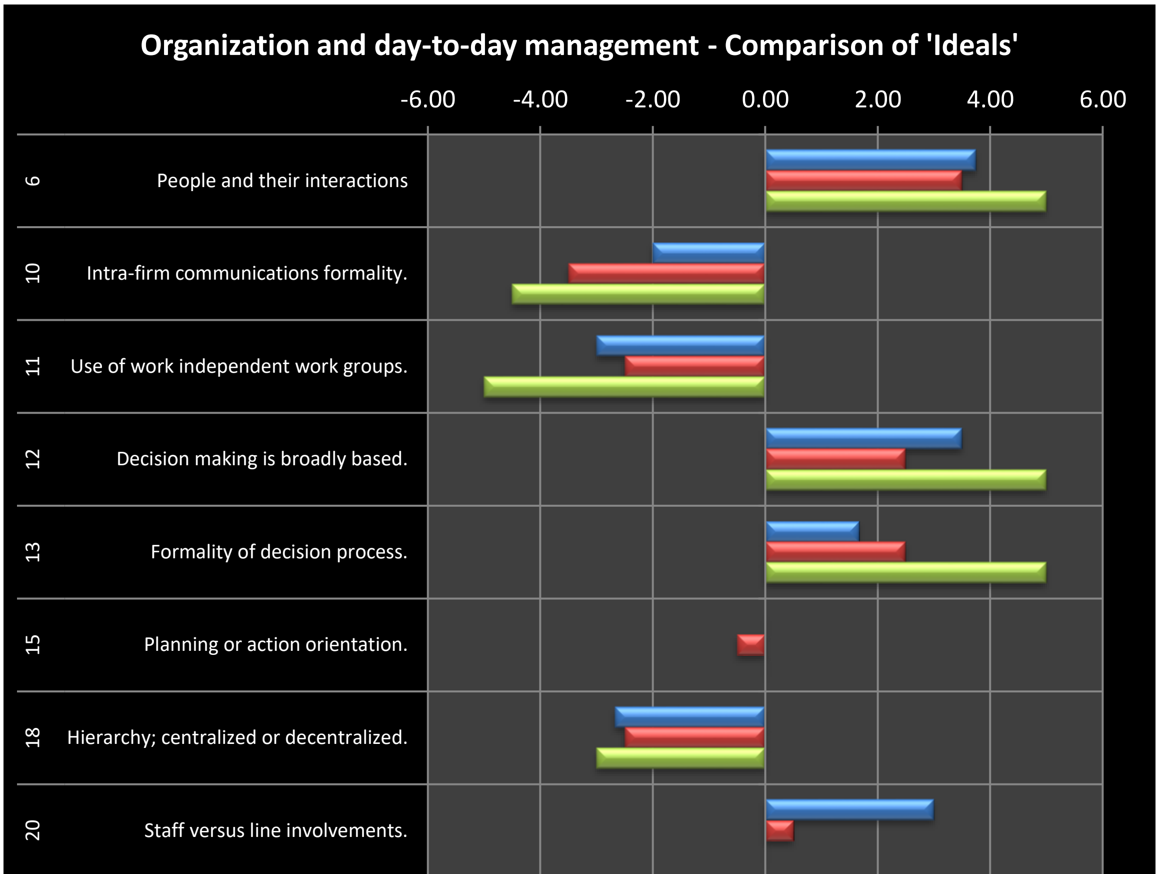
2. Organization and management of day-to-day operations

This second theme provides another means of focusing in on the management practices which, if adopted, could improve innovation in the financial industry.

A comparison of all three 'Ideals' under this theme is set out and indicates that in all six Factors, the on-line survey sourced 'Ideal' is not up to the standard of the 'BofB' benchmark. The introduction of the 'BofB' benchmark provides a measure of the challenge facing the industry more so than the views of on-line respondents.



	20	18	15	13	12	11	10	6
	Staff versus line involvements.	Hierarchy; centralized or decentralized.	Planning or action orientation.	Formality of decision process.	Decision making is broadly based.	Use of work independent work groups.	Intra-firm communications formality.	People and their interactions
'Ideal' for financial industry	3.00	-2.67	0.00	1.67	3.50	-3.00	-2.00	3.75
On-line survey 'Ideal'	0.50	-2.50	-0.50	2.50	2.50	-2.50	-3.50	3.50
Best of Breed	0.0	-3.0	0.0	5.0	5.0	-5.0	-4.5	5.0

Summary

The 'Ideal' for those in the financial services industry and respondents overall are closely aligned for six of the eight Factors; F#'s 6, 10, 11, 12, 13 and 18, but in all cases highly-innovative companies have a higher 'Ideal' than the other two groups.

Responses to two questions regarding planning versus action orientation (F#15) and staff versus line involvement (F#20) are inconclusive.

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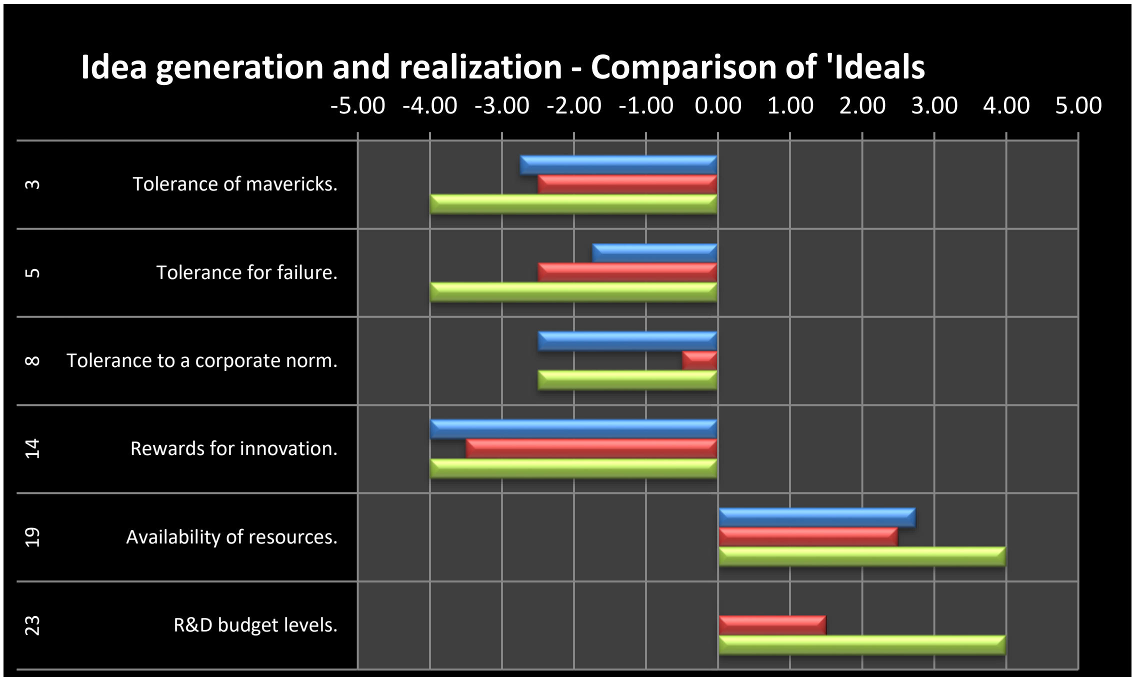
3. Idea generation and realization

Of extreme importance to the process of improving innovation is how a corporation encourages ideas of all types and from throughout the entire organization.



	23	19	14	8	5	3
	R&D budget levels.	Availability of resources.	Rewards for innovation.	Tolerance to a corporate norm.	Tolerance for failure.	Tolerance of mavericks.
'Ideal' for financial industry	0.00	2.75	-4.00	-2.50	-1.75	-2.75
On-line survey 'Ideal'	1.50	2.50	-3.50	-0.50	-2.50	-2.50
Best of Breed	4.0	4.0	-4.0	-2.5	-4.0	-4.0

Six Factors are measured in this comparison of 'Ideals'. When compared to the 'BofB', the results from the financial industry are already closely in line with the views of respondents. Tolerance for mavericks, tolerance for working outside a corporate norm, rewards for innovation and general availability of resources for new projects are all viewed as important.

The implication is that, within this theme (theme 3), the industry knows what to do, but the problem is in the implementation of good ideas – not so much their generation. Tolerance (or intolerance) for failure – Factor #5 – may loom larger than management believes.

Summary

Tolerance of mavericks is more highly valued by the BofB than for the other two groups but is an important characteristic overall. Tolerance for failure is ranked least in the financial industry. Tolerance to a corporate norm is equally important in highly innovative companies, less so in responses overall. Rewards for innovation are important to all as is the availability of resources – for beneficial projects. R&D budget levels (F#23) seem irrelevant to the financial industry.