

Financial Services Industry¹

Interpretation of segmented results provides insight into major concerns respecting the industry's management practices and innovation

Targets for improvement should come from outside the financial industry!

May 15, 2013

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

Innovation in the financial industry is 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.

The industry is in turmoil. European banks are stressed. Employment in London's financial industry is forecast to be 237,000, its lowest level in 20 years. Wall Street, while gradually emerging from the disaster of the last 5 years, is forecast to cut 21,000 jobs² or about 2% of its workforce. New regulations will impose more restraints on the ability of banks to use the same instruments to make the profits of yesteryear. With the focus on cost reduction, how is innovation to be sustained?

One of the responsibilities of leadership³ 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 innovation about?

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¹ Banking, finance, real estate and insurance

² The Economist, May 11, 2013, Special Report, Wall Street is back.

³ Securities Industry and Financial Markets Association (SIFMA) web site, May 14, 2013

A perspective on what takes place in the industry is provided by Michael Blum when he was asked⁴ whether there was any space in banking for innovation.

'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.

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.

In this paper we look at the management practices which support or discourage innovation in the financial services industry. We do so by making use of information drawn from our on-line survey instrument which is based on the management practices of highly-innovative companies. To quote; 'Traditional approaches⁵ 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 management practices make sense?



Executive Summary

Respondents to the on-line survey⁶ who are from the financial industry reveal that their major concerns are;

- Rewards for innovation and career opportunities and recognition for innovators
- Too much emphasis on cost reduction in the planning process and not enough attention given to identifying opportunities
- A concern over hierarchy and centralization of decision making
- Intra-firm communications

By themselves, these opinions may not be a major concern to management, but given the desire to make industry managers more entrepreneurial, the findings are important. Management needs to know more about the culture of their own organization and tailor an approach to innovation which addresses priority concerns.

⁴ <http://www.imd.org/news/Banking-executive-underscores-importance-of-innovation-in-the-financial-services-industry.cfm>, March 19, 2013

⁵ http://en.wikipedia.org/wiki/Open_innovation_in_financial_services

⁶ On-line survey is available at no cost at <http://www.corporateinnovationonline.com>

The conclusions reached seem supported by external sources.

- According to Fasnacht⁷, 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 business⁸. Highly-innovative companies which we have researched have a culture which is reinforced by management practices designed to build and sustain innovation.
- According to a recent report⁹, 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.

Our 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!

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.

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 the ‘Reality’ of their situation as compared to their view of their ‘Ideal’ for 25 Factors. The difference between the ‘Ideal’ and their ‘Reality’ is a measure of their satisfaction with their organizational and management arrangements.

⁷ http://en.wikipedia.org/wiki/Open_innovation_in_financial_services

⁸ Banking executive underscores importance of innovation in the financial services industry. An interview with IMD alumnus Michael Blum

⁹ 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.

Company size can influence results. All respondents to the on-line survey are employed with organizations having fewer than 5000 employees.

Lastly, we compared respondents' results with our benchmark for measuring best management practices impacting innovation.

Observations regarding on-line survey results

Those completing the on-line survey and making use of the analysis should be aware that there are a few differences between the 'Ideal' as registered by respondents in general as compared to those who register themselves as engaged in the financial industry. These differences, as illustrated in the table in the Appendix A; 'Comparison of 'Ideal' as between overall respondents and those in the financial industry', are not hugely significant but none the less should be noted in any subsequent analysis.

- The 'Ideal' in the financial services industry is more demanding than for overall respondents for Factor #7; career and recognition of innovators, for Factor #8; tolerance to a corporate norm and for Factor #17 regarding loyalty – the corporation demands 100% of there is room for personal development (reference the 15% for 3M and Google's similar position). For all 3 Factors a higher level is demanded by respondents in the financial industry when compared to respondents overall.

Thus, when interpreting results, adjustments for the differences in 3 of the 25 Factors may be required.

The "Ideal" as viewed by those in the financial industry is fundamentally the same as all other respondents. In this respect the **financial industry is no different than other industries** when it comes to what they believe constitute the best management practices to encourage innovation.

Thus 8 Factors represent barriers to instilling entrepreneurship and innovation in the financial industry. The problem areas are better defined. The ‘elephant’ in the room becomes more articulated! Options for taking action to improve the situation can therefore be targeted.

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. Were respondents drawn from the investment banking – risk taking – side of the business, the concern seems poorly placed, given typical compensation levels for this group. The implication is that the majority of respondents are from other than the investment group. Our 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 difficult.

SIFMA¹⁰ sets out the responsibilities of leadership in the financial sector, and that is to ‘*create an inclusive environment in which all employees are encouraged to be innovative and share ideas*’. This objective was highlighted at the beginning of this paper. While all of the Factors are impacted by the stance of ‘leadership’ we have highlighted those most relevant to leadership from other characteristics. Three themes are set out for purposes of comparison.

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

White & Partners has developed a higher level benchmark¹¹ 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 the Best. If management of the financial services industry wishes to become more innovative, the best practices of these companies should be used as a benchmark, with challenges even higher than represented by the on-line survey results.

1. Leadership

We have isolated 5 Factors which come under the theme of ‘Leadership’ and provided a comparison of all three ‘Ideals’ under this theme. A chart – Appendix B – sets out the results.

The inclusion of the BofB benchmark suggests that the leadership of highly-innovative companies places 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 and that 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.

¹⁰ Securities Industry and Financial Markets Association

¹¹ For more information on the Best of the Best benchmark, please visit the web site; <http://www.corporateinnovationonline.com>

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

A 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 in Appendix C and indicates that in all 6 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.

3. Idea generation and realization

Of extreme importance to the process of improving innovation is the manner by which the corporation encourages ideas of all types and from throughout the organization. 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 for failure – Factor #5 – may loom larger than management believes.

Conclusion

For managements wishing to improve innovativeness and innovation, the central message is

- Each organization is different in terms of its culture for innovation
- Knowing more about that culture is a key first step
- Aim high and take guidance from the established management practices of highly-innovative companies even outside the financial services industry.
- Track progress with the same tools used to define the problem.

Respectfully submitted

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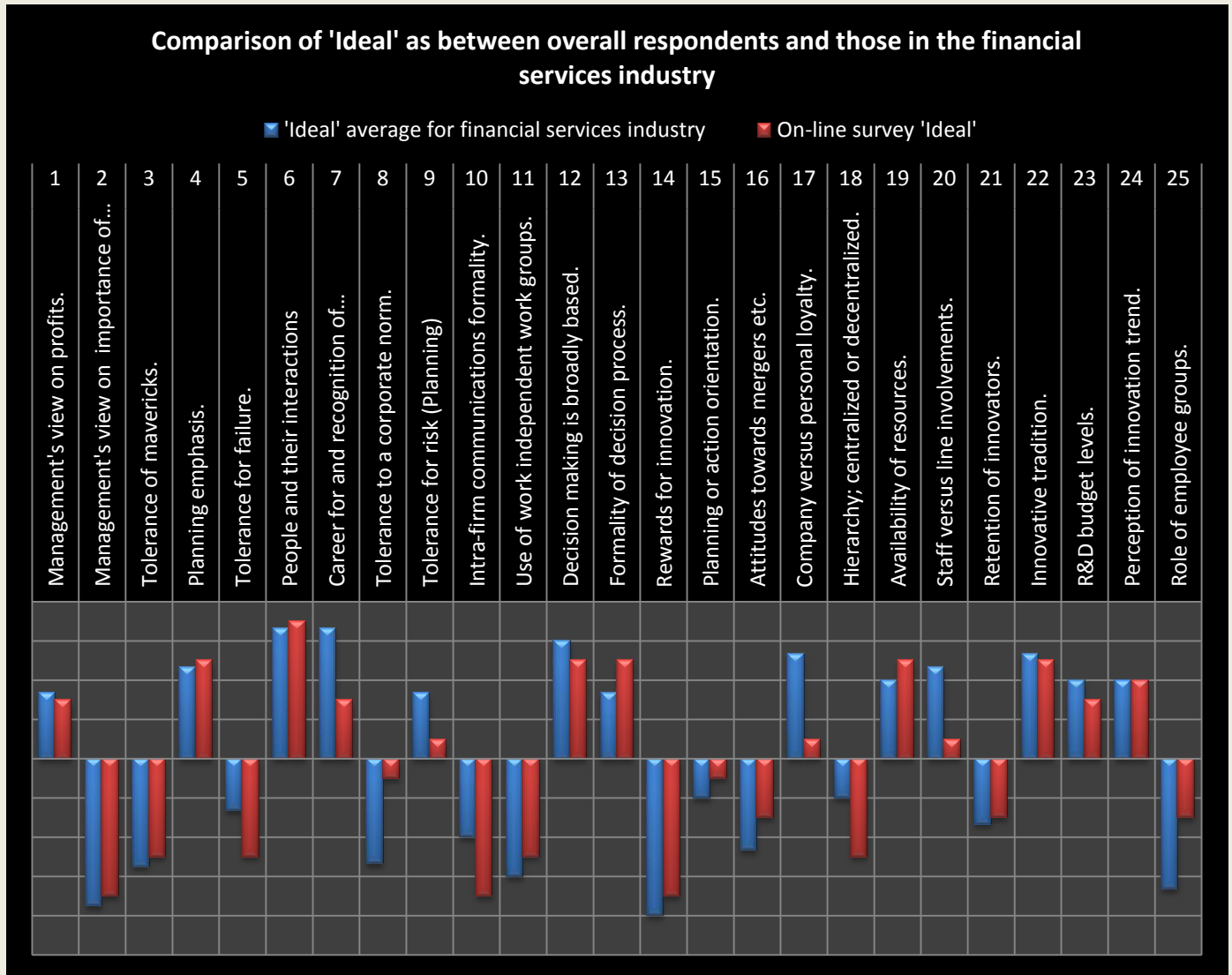
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Appendices

A. What is your 'Ideal' management practice?

The chart compares responses for each of 25 Factors as between those in the financial industry compared to all responses to the on-line survey.

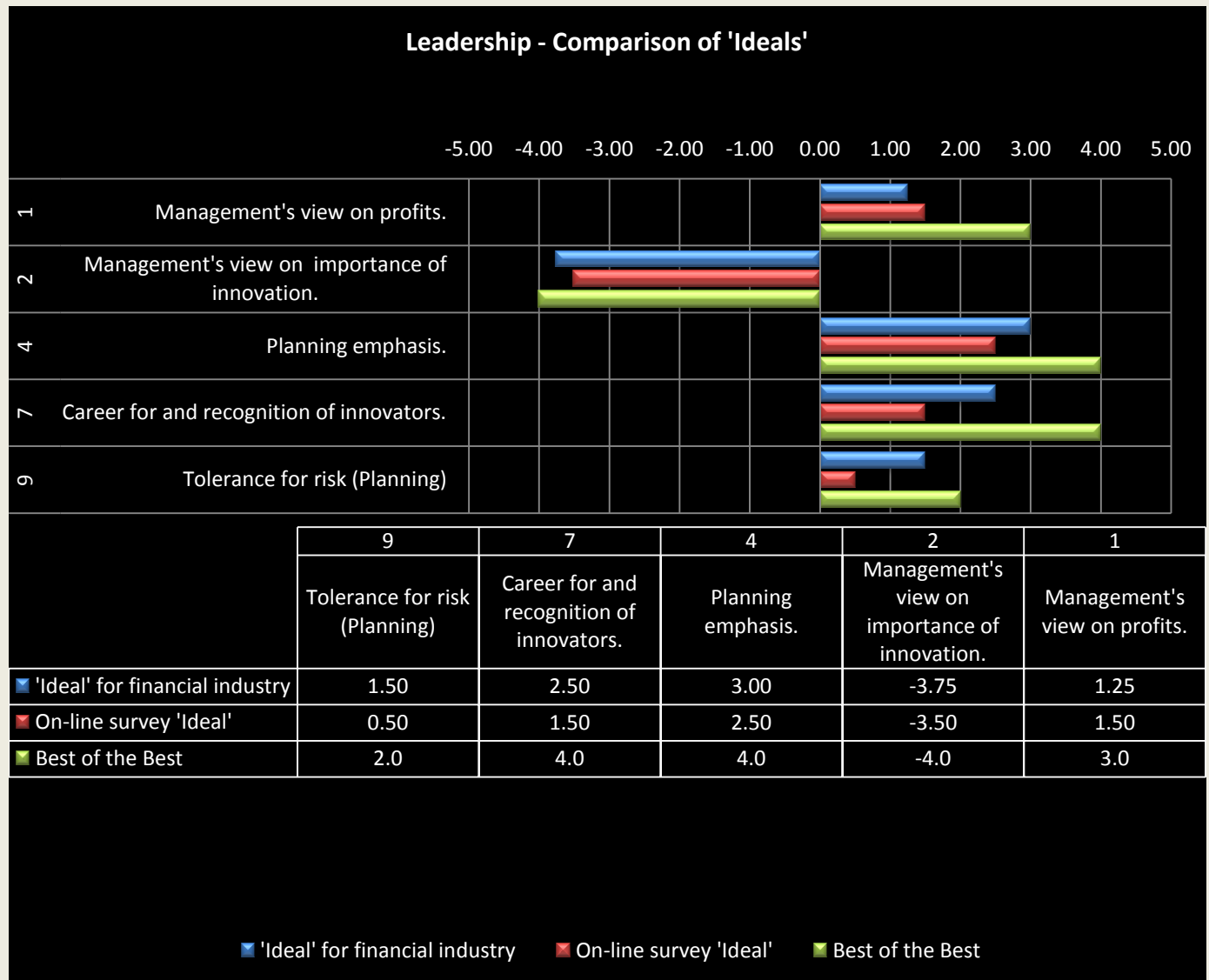


Summary

There is a close alignment amongst at least 22 Factors as between overall responses compared with those from the financial industry.

B. Leadership comprises 5 Factors.

Responses to the question; 'What is your 'Ideal'?'

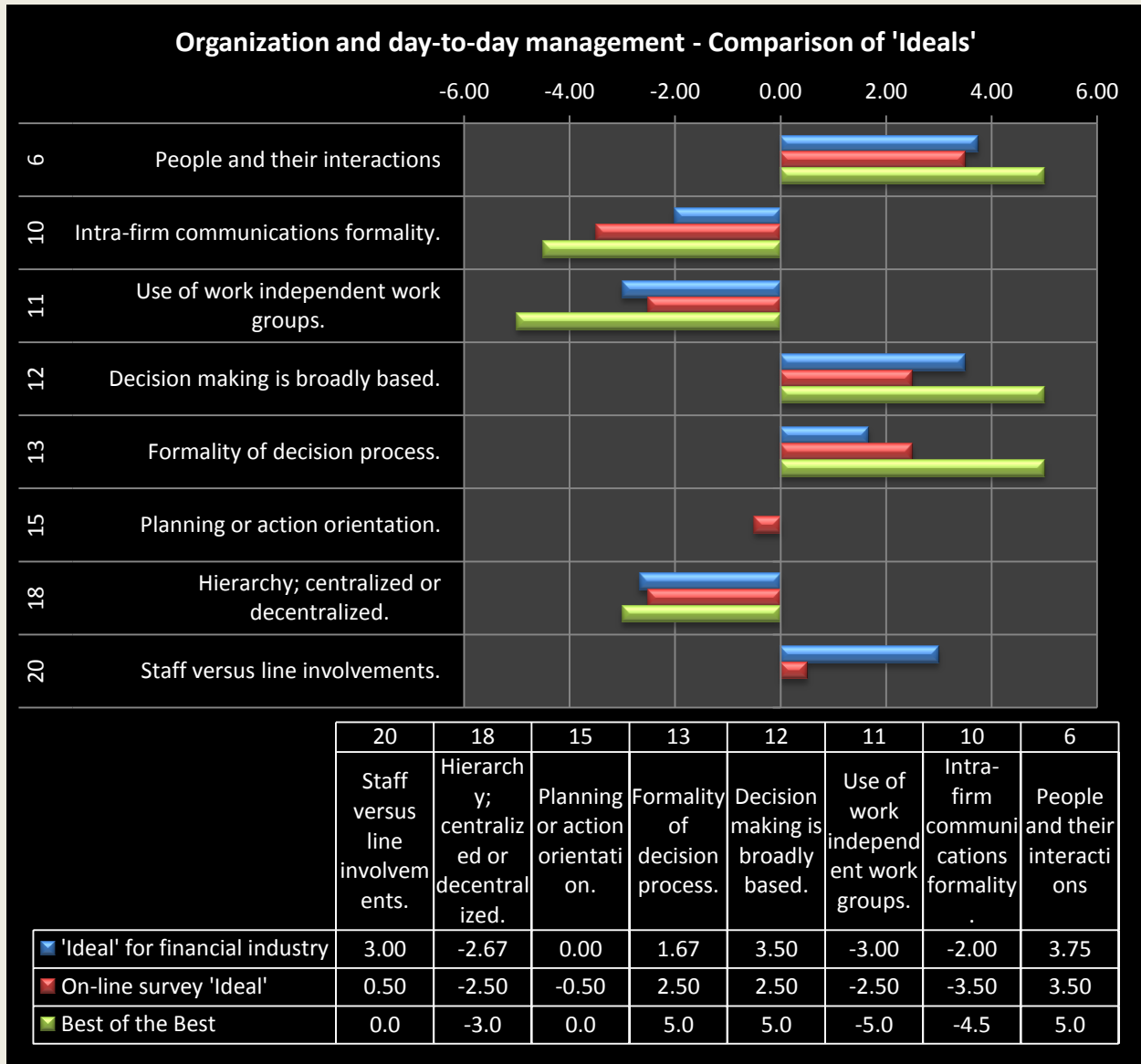


Summary

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.

C. Organization and management of day-to-day affairs is comprised of 8 Factors.

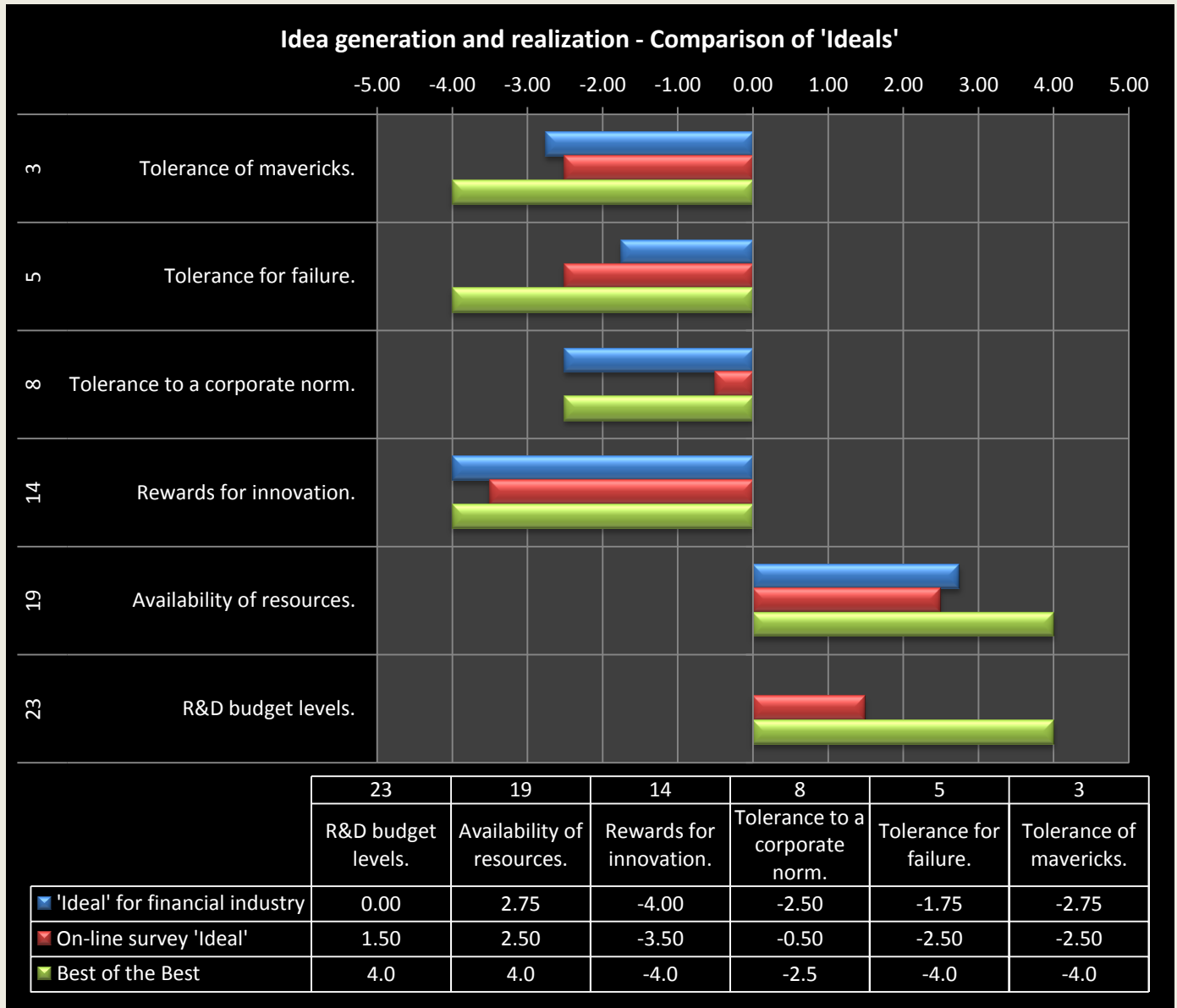
Responses to the question; What is your 'Ideal'?



Summary

The 'Ideal' as identified by three sources is closely aligned for 6 of the 8 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.

D. Idea generation and realization is comprised of 6 Factors. Responses to the question; What is your 'Ideal'?



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. The question regarding R&D budget levels seems irrelevant to the financial industry.