Innovating banking

Lessons from the world's leading innovators

IBM Institute for Business Value

Executive Report

Banking

How IBM can help

To succeed in today's environment, businesses need to lead through increased complexity and volatility, drive operational excellence and enable collaboration across enterprise functions, develop higher quality leadership and talent, manage amidst constant change and unlock new possibilities grounded in data.

Innovation — the key to future growth

Rapidly changing customer expectations, increasing regulation and ever-greater competition from financial technology companies and other new entrants make traditional banking today a much less comfortable activity than in times past. With margins shrinking and economic uncertainty increasing, bankers recognize the need for a more agile, digital, connected and entrepreneurial operational and business environment. Innovation is no longer optional, but has become a necessity, fundamental to the success of traditional banks. Bankers need to approach innovation more systematically, driving innovation across their organizations, culture and processes. This executive report highlights key innovation lessons from the world's the most successful organizations and identifies specific strategies that can help banks innovate and outperform.

Executive summary

Banking is at a crossroads. Banks today are confronting increasing regulation and compliance costs, an alarming rise in security and fraud, and more ardent customer demands – all as a result of innovative new technologies and the emergence of aggressive, non-traditional competitors. For many banks, profits are stagnating.[1]

Regulators are stepping up enforcement across a number of areas, including consumer protection, anti-trust, money-laundering, foreign-exchange trading and sanctions violations.

Cyber security has risen to the top of the risk agenda at financial institutions of all sizes, with banks' integral role in payment ecosystems leaving them entangled in the often messy aftermath of security breaches and consequent economic and reputational loss.

To redress challenges in financial performance, banks continue to seek operational efficiencies – simplifying operations, searching for scale efficiencies and rationalizing branch networks. But cost savings are not enough. Generating new revenues will depend upon much better understanding of customer demands, with banks needing to embrace novel ways of penetrating deeper into the lives and habits of both retail and business customers.

With new technologies rapidly evolving and consumer expectations expanding, banks are expected to deliver superior, personalized and seamless retail service across all channels – all on demand. Similarly, wholesale and high-net-worth clients are expecting financial institutions to have deeper insight into their individual preferences, as well as anticipate their every want and need.

To understand how banks can rise to the innovation and opportunities facing them, the IBM Institute for Business Value (IBV) collaborated with the Economist Intelligence Unit (EIU) to survey 1,004 C-suite level executives or their direct reports from 17 industries from around the world, including 85 from banking and financial markets. The objective was to identify the most valuable innovation lessons that banks can apply to their own businesses. We analyzed survey data using regression analysis to identify correlations between business performance and innovation. We were able to identify three key themes associated with financial outperformance in which banks lag behind innovation leaders:

Organizational structures and functions that support innovation — The most successful organizations align innovation activities directly with business objectives, pursue "open" innovation structures and create specialized innovation teams.

Cultural environments to make innovation thrive — The most successful organizations maintain a clear focus on innovation across all business activities, encouraging innovative behaviors and finding ways to sustain innovation momentum.

Processes to convert ideas into innovation — The most successful organizations source new ideas from diverse locations, often leveraging big data and analytics; innovation is funded separately and measured rigorously.

At the same time, an increasing number of non-traditional competitors are disrupting the banking status quo. For example, multi-national retailer Tesco now offers a range of core banking, insurance and credit services.[2] And a multitude of financial technology (fintech) companies, including major consumer electronic businesses, are entering into banking and payments value chains.

In the face of this rapidly evolving banking environment, innovation capabilities, once considered a "nice to have," are becoming central to the everyday business of banking. Innovation is the one activity that can address banking imperatives across varied dimensions. Innovation enables banks to streamline operations, transform functions, create efficiencies and develop superior capabilities. Innovation brings to customers new types of products and services, as well as compelling new experiences. And innovation can help define new partnering and business models, disrupting traditional banking industry value chains and enterprise models.[3]

Innovation is strongly correlated with value creation

An examination of the market capitalization growth of innovative banks demonstrates a close correlation between innovation and financial performance (see Figure 1). Examining financial performance of the most innovative banks cited by The Banker revealed a 24 percent growth in market capitalization from 2011 to 2014 compared to the overall market.[4] This is a full 7 percentage points higher than the average of the Standard and Poor's S&P Global 1200 Financials Index.[5]

Figure 1

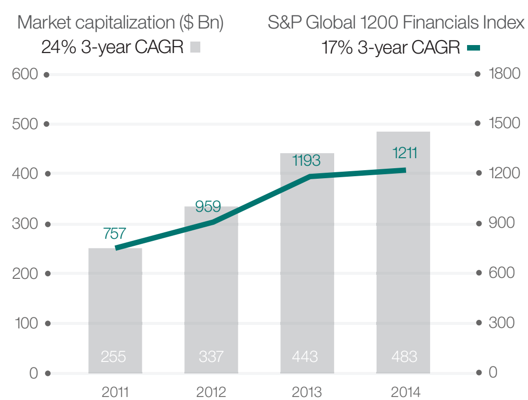
Innovative banks outpace the overall industry in value creation

"The Banker" Innovation Award Winners 2013

1. Akbank (Delivery channel, customer service)
2. Barclays (Wealth transaction)
3. Banamex (Retail payments)
4. BNP Paribas (Capital markets, dealing tech)
5. Banko Bradesco (ATM)
6. Citigroup (Risk)
7. Caixa Bank (Green IT)
8. Deniz Bank (Retail banking, social media, mobile)
9. RBS (Global transaction, wholesale payments)

Market capitalization growth

Top 9 innovative banks vs. S&P Global 1200 Financials Index



Source: The Banker "Innovation in Technology and Transaction Banking Awards 2013." The Banker; market capitalization and growth data from Ycharts, Google Finance & Gurufocus; S&P 1200 (Financial) data from S&P Dow Jones Indices.

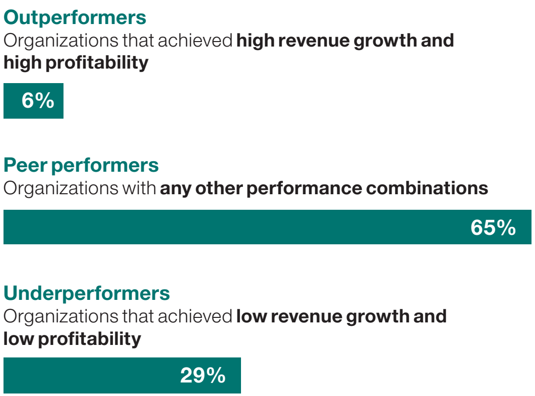
in•no•va•tion \, i-nə -'vā-shən\Noun
Origin: Latin, 1548
Derives from the Latin word innovatus, past participle of innovare, "to make changes; do something in a new way," from in- + novus -"new"

Merriam Webster Dictionary

Figure 2

Our 2014 global innovation survey shows 6 percent of organizations outperform in revenue and profitability growth

Three performance categories emerged



Source: IBM Institute for Business Value

Successful organizations do innovation differently

To derive the most benefit from innovation, banks must embrace it holistically and systematically. Globally, only 6 percent of organizations surveyed in our IBV/EIU 2014 Global Innovation survey outperform others in both revenue growth and operating efficiency (profitability). We asked executives to rank themselves against their competitors along the two metrics. Using the survey respondents' ranking, we identified three specific categories of performance: outperformers, underperformers and peer performers (see Figure 2).

Performance analysis allows us to answer two important questions. What do the top organizations do differently when it comes to innovation? And how do they consistently outperform their peers?

We found that outperformers:

- Build an organization that encourages innovation
- Create a culture that fosters innovation
- Design processes that enable innovation.

Build an organization that encourages innovation

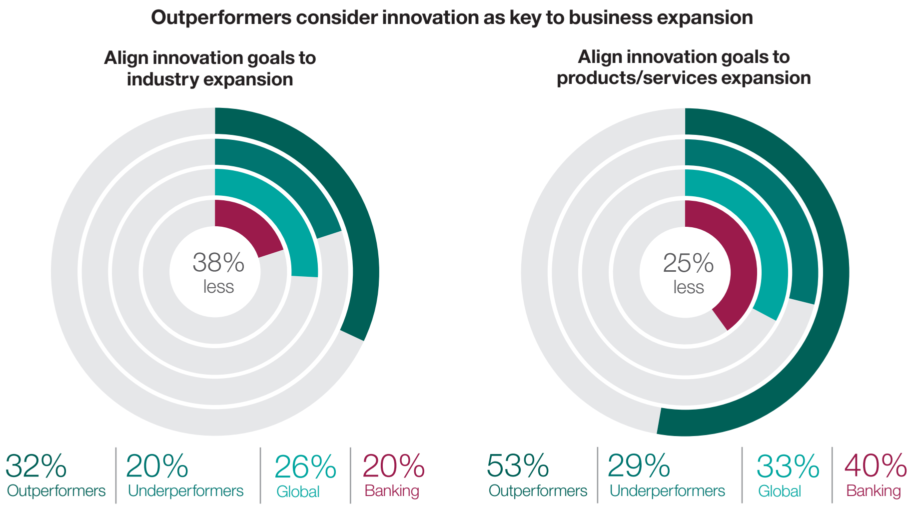
The most successful companies create innovation structures and functions that align with and support their underlying business objectives. They:

1. Align innovation with business goals – Outperformers promote innovation targets that support and reinforce their business objectives (see Figure 3). For example, outperformers align innovation goals to the development of products and services 84 percent more than underperformers.

Banking tends to be less aligned with business strategy than other industries. However, in spite of this, senior management support in banking does not seem to bebarrier to innovation for banks, with only 5 percent of banking executives identifying it as such.

Figure 3

Outperforming organizations explicitly align their innovation objectives with business goals



Source: IBM Institute for Business Value.

First Tennessee Bank – innovative marketing analytics drives a major return on investment (ROI)[6]

U.S.-based financial services company, First Tennessee Bank, adopted an innovative, analytics-centered marketing strategy aimed at growing the bank by increasing marketing effectiveness.

Using predictive analytics to measure the effectiveness of marketing campaigns on an ongoing basis, the bank was able to optimize its marketing investments and calibrate them as appropriate. The result: a major improvement in marketing effectiveness, with an big increase in marketing spend ROI, increases in campaign response rates and an overall decline in marketing costs.

Garanti Bank creates individualized mobile experiences[7]

Garanti Bank, Turkey's second-largest private bank, collaborates with third parties to provide customers an individualized mobile customer experience. The bank offers a mobile dashboard, iGaranti, that lets users select desired features of their mobile banking apps and offers 15 optional specific-purpose apps.

iGaranti has adopted an open philosophy, working with third-party apps such as Bonubon, a daily deals site; Markafoni, a private shopping site; and Biletix, the largest seller of event tickets in Turkey, to help motivate and drive innovation in customer experience.

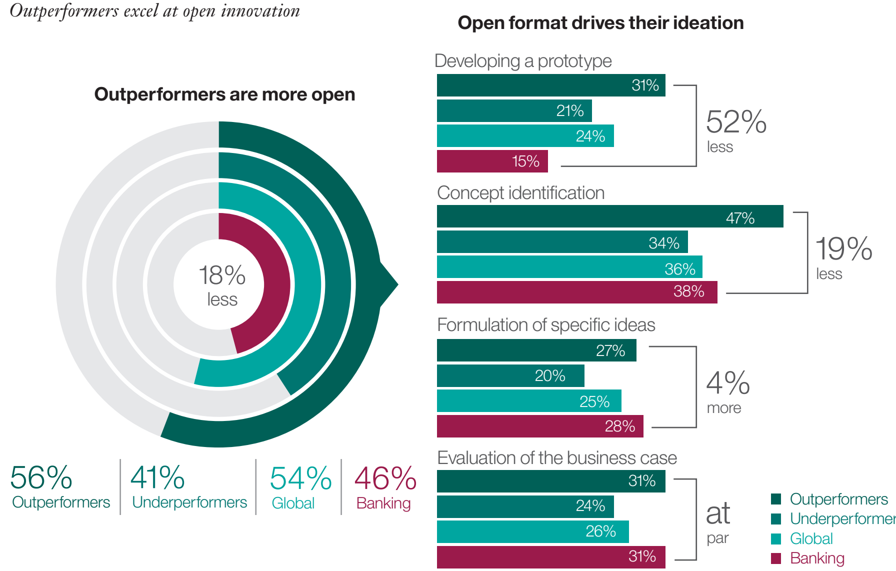
Garanti is widely acknowledged as one of the most innovative banks in Europe, winning "Best Consumer Internet Bank in Romania," a key market, twice in succession.

2. Structure open forms of innovation – Outperformers build robust structures to promote and support open innovation (using internal and external ideas and/or embracing open-innovation concepts, such as crowd sourcing).

Despite 69 percent of banking executives saying they believe open innovation promotes an innovative environment and 60 percent saying it leads to better and faster idea development, banks tend to be less open than companies in other industries (see Figure 4).

Figure 4

Outperformers excel at open innovation



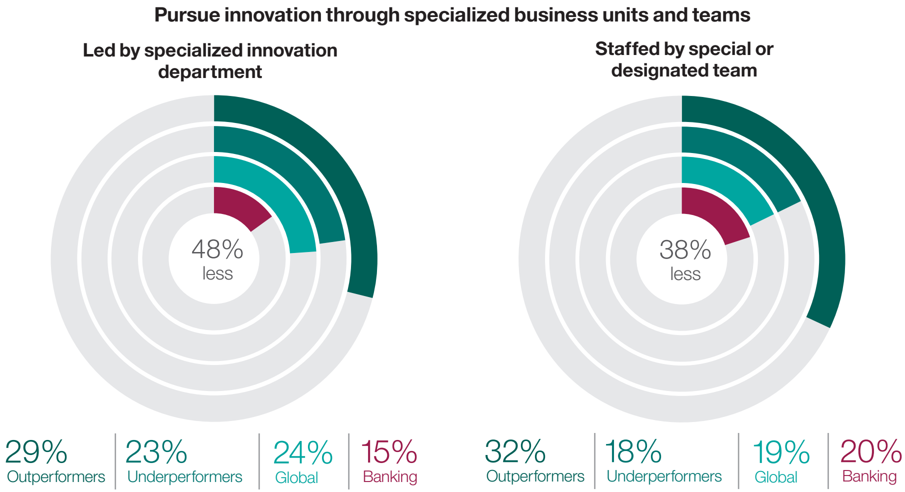
Source: IBM Institute for Business Value.

3. Create specialized teams – Outperforming organizations are more likely to create dedicated innovation teams. Outperformers are 79 percent more likely to establish and maintain a special or designated innovation team than underperformers, and those teams are 24 percent more likely to be part of a specialized innovation department.

Few banks however, have dedicated innovation teams. With much of the innovation in many banks focused on specific products and services in business units, most banks have not yet embraced a systematic innovation strategy (see Figure 5).

Figure 5

Outperformers are more likely to have specialized innovation teams



Source: IBM Institute for Business Value.

Citi sets up innovation labs[8]

Innovation is the driving force behind the growth of Citi.

Citi established specific innovation labs around the world that focus on developing new ideas. Innovation labs use mobile, supply chain technologies and analytics to engage customers innovatively, more actively and continuously.

Labs are used to test new ideas, run pilot projects and fine-tune existing solutions. Results that might have previously taken weeks are now being completed in days or hours. Innovation labs contribute to Citi's growing recognition as an innovation leader in transaction banking.

mBank innovates with online transactions[9]

Polish direct bank mBank is an innovation leader, embracing innovation as fundamental to business strategy. mBank has disrupted industry business models through the creation of a compelling mobile payments service and other innovations, such as a “loan-in-30-seconds” concept.

Launching an innovative online transaction system in 2013, mBank increased sales per 1,000 log-ins from less than one product to more than 12. mBank has improved sales significantly, recording record high income from core activities and expanding its customer base to more than 4.5 million clients.

Outperformers build an organizational culture conducive to innovation

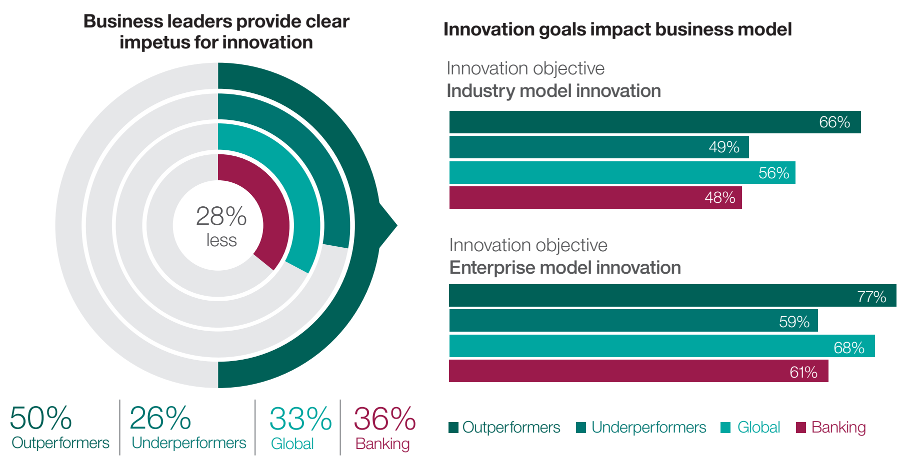
Creating cultures and environments in which innovation can thrive is crucial for successful innovation:

1. Lead with an innovation focus – Outperforming organizations explicitly promote innovation as central to business activity. Outperformers are 92 percent more likely to provide a clear direction and impetus for innovation than underperformers (see Figure 6). They are more open to industry and enterprise model innovation, and are 27 percent more likely to link innovation efforts with financial performance.

Banks tend to be less focused in their innovation activities, scoring lower than industry averages in pursuit of business-model and enterprise-model innovation.

Figure 6

Outperforming organizations actively encourage their employees to innovate



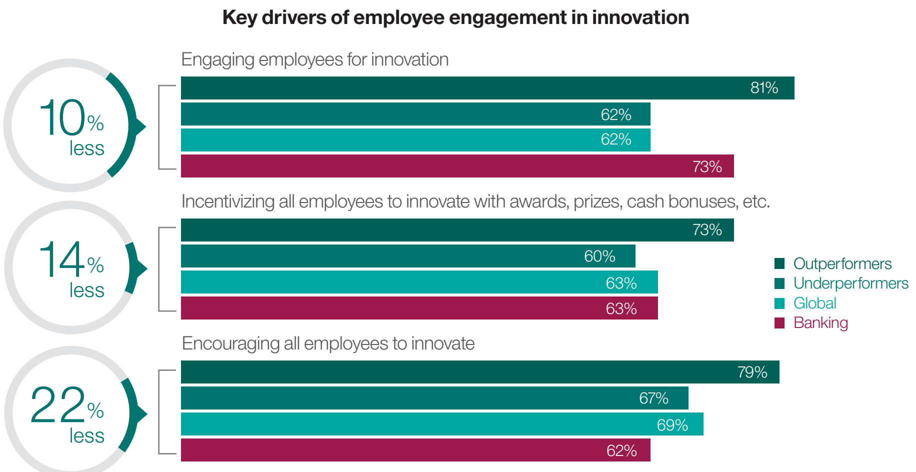
Source: IBM Institute for Business Value.

2. Encourage innovative behaviors – Outperforming organizations are 17 percent more likely than underperformers to actively encourage innovation by employees through specific incentives and rewards. And they are 31 percent more likely to engage employees directly in innovation processes (see Figure 7). Outperforming organizations also have a greater tolerance of failure, being 25 percent more likely than underperformers to accept that some innovation projects will not succeed.

In banking, tolerance of failure is higher than many industries. Forty-four percent of executives say they believe their organizations will tolerate failure in innovation, the second highest of any industry surveyed, and compared to just 31 percent across all organizations.

Figure 7

Outperforming organizations actively encourage their employees to innovate



Source: IBM Institute for Business Value.

OCBC Bank encourages innovative thinking[10]

Overseas Chinese Banking Corporation (OCBC), based in Singapore, embraces innovation across the business.

OCBC established an innovation lab in which staff at all levels gather to brainstorm new areas of innovation. Employees are encouraged to think creatively and innovatively, and to seek ways to improve the workplace and customer interaction.

OCBC rolled out an innovation portal for staff to contribute suggestions, and more than 5,000 ideas have flowed over the past three years. One recent innovation reduced both processing time for credit-card applications and the time needed to train staff.

ICICI uses technology to sustain innovation and improve customer experience[11]

Indian bank ICICI constantly innovates to improve customer experience by embracing new technology faster and more consistently than many of its competitors.

ICICI used social media to launch new offerings through Facebook, created a real-time dashboard to integrate customer complaints from Twitter and Facebook into its customer relationship management systems, and pioneered a cardless cash withdrawal service in 2014.

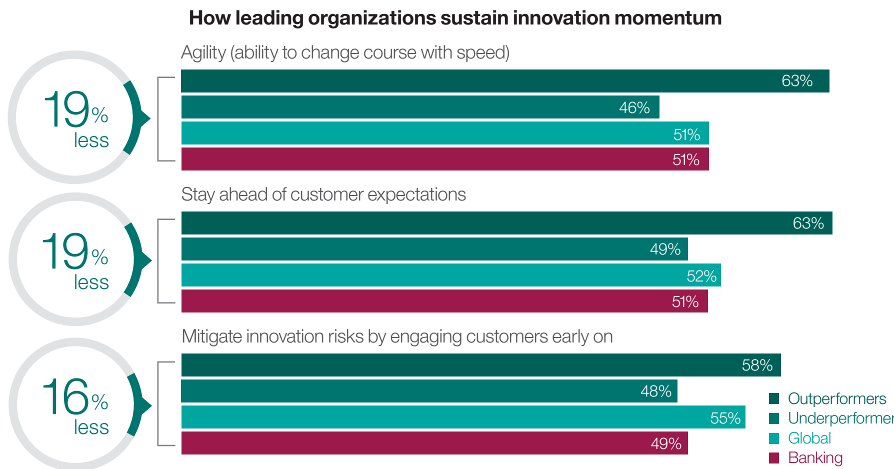
With its strategy of continuous and sustained innovation, ICICI has been able to achieve double-digit growth, even during periods of economic disruption.

3. Sustain innovation momentum – Outperforming organizations are better able to stay ahead of the market. They value agility, actively work to stay ahead of changing customer attitudes and expectations and bring customers into innovation activities early to capture new insights and mitigate risks (see Figure 8).

For banks, trust is a key cultural element identified to support innovation. Thirty-nine percent of banking executives say trust is critical to innovation, compared to 32 percent for outperformers and only 24 percent overall.

Figure 8

Outperforming organizations are more agile in sustaining innovation momentum



Source: IBM Institute for Business Value.

Outperformers have clear processes to source, fund and measure innovation

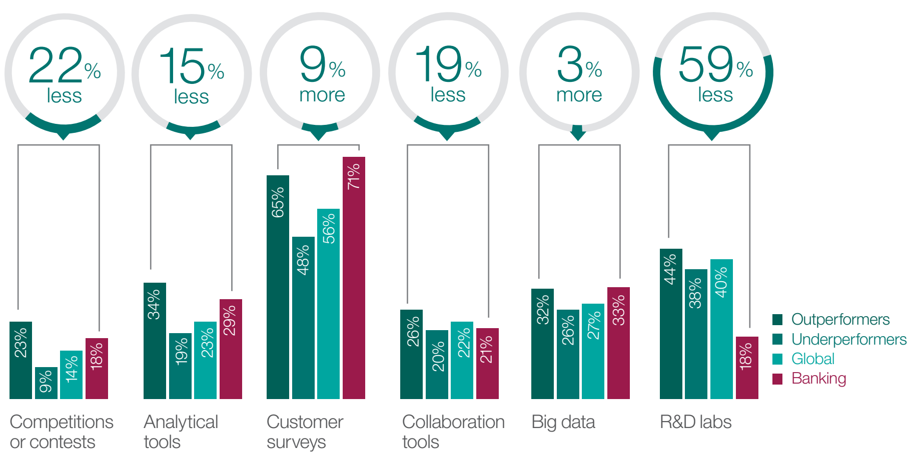
The most successful organizations develop innovation from a diverse range of sources, directly funding new ideas and explicitly measuring innovation effectiveness. They:

1. Source new ideas from a wide range of sources – Outperforming organizations use more channels and sources of input into ideation. They are 23 percent more likely to use big data and 79 percent more likely to use analytics to reveal new business opportunities. They are 35 percent more likely to use customer surveys and 156 percent more likely to sponsor competitions and contests (see Figure 9).

Banks are better than average at using customer surveys to gauge new ideas, and are on par in their use of big data for innovation, albeit off a low base. However banks tend to rank lower in their use of other inputs for ideation, including collaboration and analytics tools.

Figure 9

Outperforming organizations find new ideas from a variety of sources



Source: IBM Institute for Business Value.

Barclays uses crowdsourcing and open innovation events to drive innovation[12]

Barclays, a global bank based in the United Kingdom sources ideas from crowd-sourced platforms and open innovation events. Barclays' "Your Bank" platform is an ideation environment in which Barclays invites its customers to help drive innovation.

Barclays works closely with startups to boost IT innovation. It has established an open innovation event in which entrepreneurs come together to innovate, and to help define and characterize the future banking industry.

BBVA Ventures creates shareholder value by investing in start-ups[13]

BBVA, a Spain-headquartered, multinational banking group, has set up its own venture fund to finance transformational innovation. BBVA Ventures partners with start-ups, incubators and venture capital funds to invest in innovations in the finance sector. It has invested in more than 500 start-ups.

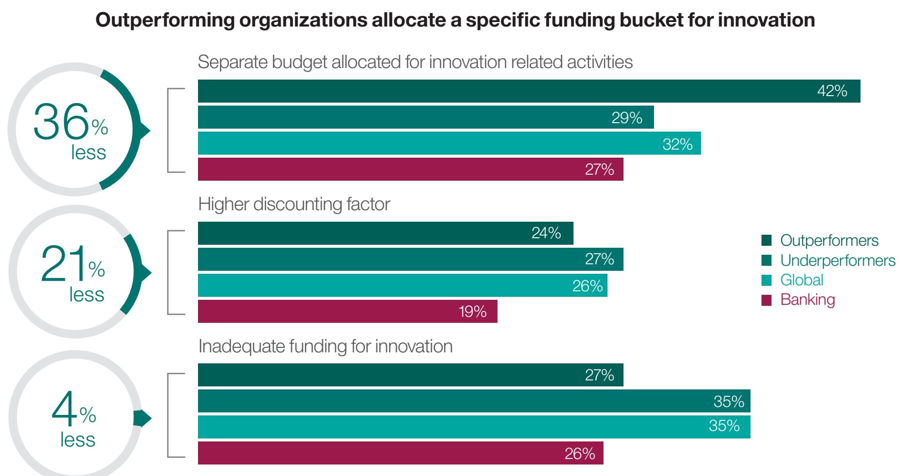
BBVA Ventures uses its unique expertise and experience to identify emerging trends and opportunities, and create new businesses that create and expand shareholder value.

2. Fund innovation – Outperforming organizations are more likely to approach innovation with the same disciplined approach they would any other business process. They are 45 percent more likely to allocate dedicated funding to innovation. They use business-case methodologies to make go/no go decisions on specific innovations, and are more likely to consistently maintain for innovation activities.

Banks, however, tend not to secure separate, dedicated funding sources for innovation. But despite this, 26 percent of banks surveyed identified funding constraints as a barrier to innovation, the lowest of any of the industries surveyed (see Figure 10).

Figure 10

Outperforming organizations fund innovation separately from other projects



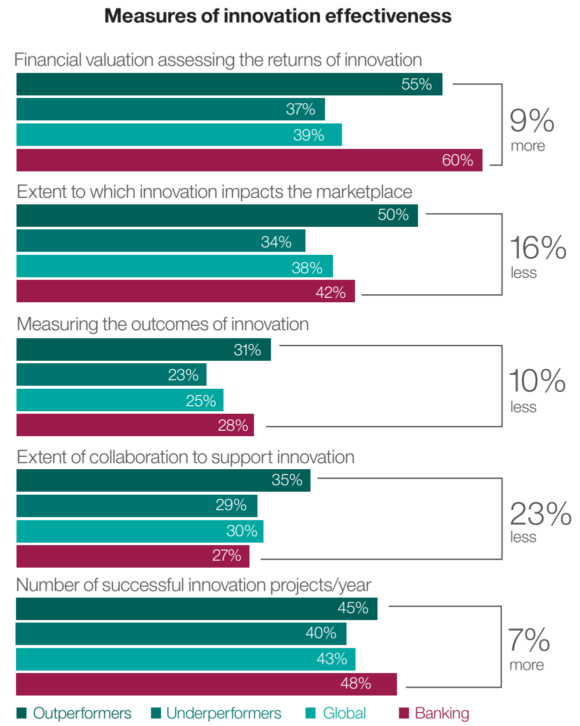
Source: IBM Institute for Business Value

3. Measure innovation outcomes – Outperforming organizations hold innovation projects accountable to clear financial objectives. They are 35 percent more likely to explicitly measure the outcome of innovation initiatives than underperformers. Specifically, they are 48 percent more likely to measure financial return on investments from innovation, and 47 percent more likely to assess its impact on their markets. By promoting accountability and transparency in innovation spending, outperformers are better able to justify its continuing funding. As such, outperforming organizations are more likely to secure stable investment and minimize the vagaries of budgeting.

With their strong financial analysis capabilities and quantitative sensibility, banks are also highly focused in applying robust financial metrics to innovation projects. Sixty percent of banking executives surveyed say they use ROI measures to assess the effectiveness of their innovation, 9 percent higher than outperformers and by far, the highest of any industry (see Figure 11).

Figure 11

Outperforming organizations measure financial return on investments from innovation



Source: IBM Institute for Business Value

Banks can learn innovation lessons from the most successful performers

Financial outperformers have created organizations, cultures and processes that allow innovation to thrive. To follow suit, banks must focus on:

Organization

Banks need to make innovation part of their organizational core. Bank organizational design should be as much about innovation as it is about providing banking products and services. Innovation should be aligned with business goals. Senior management support for innovation as a core mission of the bank should be established. Operational models should orient around open innovation, promoting conditions for the development of agile banking ecosystems. Specialized innovation teams and formal structures should be formed. And robust innovation governance and capital guidelines should be established.

Culture

A culture that fosters innovation and organizational agility is a necessity. To build this, banks must place customer-centric innovation at their organization's core. Disruptive business-model innovation should be encouraged – banks must recognize that fintechs are unleashing a wave of disruptive innovation that impacts traditional banking value chains and revenue models. To stay ahead, banks need to be at the vanguard of innovation. Employees need to be empowered and rewarded for open collaboration and innovation. Communications programs that manage expectations are vital. And agility, speed and flexibility must be prioritized.

Process

Rethinking processes to facilitate innovation is a fundamental step in the innovation journey. To be effective, executives need to tap into predictive analytics and big data to open up new ways of thinking about banking. R&D labs and ideation platforms should be pursued to jumpstart thinking. Once innovation projects are in place, clearly defined governance approval processes need to be established to manage them. Dedicated funding for innovation should be secured, and innovation efforts should be measured based on quantitative financial metrics.

Conclusion

Banking is rapidly becoming a new center of disruptive innovation. To survive and succeed in the presence of disruption, banks need to put aside their conservative roots and embrace innovation in all its forms. The innovation imperative has become continuous and incessant. To innovate successfully, banks need to adopt a systematic approach. Innovation is no longer a “nice to have” it is an absolute necessity. This executive report has outlined nine valuable innovation lessons from the most successful innovators in the world. These lessons provide a clear direction and tangible approach for banks to embrace and adopt for their innovation journey.

Are you ready to innovate?

To determine where you are in transforming organization, culture and process to create an innovative organization that has the potential to join the ranks of financial outperformers, ask yourself the following questions:

Innovation organization

- How are you aligning your innovation strategy with your business strategy?
- How can you better organize innovation teams and responsibilities?
- How are you opening up your innovation processes?

Innovation culture

- In what ways do you promote innovation as a core business activity?
- How are you encouraging your employees to innovate?
- How do you sustain the innovation momentum created?

Innovation processes

- How can you expand the sources for new ideas ?
- How can you improve allocation of funds for innovation?
- How do you measure innovation performance?

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