Hello, I’m Kim Hedley of IBM’s Institute for Business Value and with me today is John White, America’s Banking Lead of the Institute for Business Value. The IBV banking team recently released a study titled “Dare to be different: Why banking innovation matters now.” This study outlines how banks can use innovation to promote growth in their institutions.

John, now we’ve heard a lot about innovation over the past year. Do banks really see innovation as critical?

John White: Well Kim, we’ve had a lot of interest from our banking clients on the topic of innovation over the past year and we’ve seen a number of innovative initiatives in the banking space that we see having a real impact. In fact, a recent CEO survey by IBM on the subject of innovation that included 84 banking CEOs found that fully half of CEOs see the need for extensive change to their institutions over the next two years.

Added to that, we see innovation changing the industry in some fundamental ways.

Kim Hedley: So, why is innovation so important for banks now, in today’s industry environment?

John White: Innovation is more important today because differentiation is more important in today’s environment, and for two main reasons. One is that banks are returning to their focus on growth. Banks did a good job of reducing costs and increasing efficiency in the last few years. But now, flattening returns in the areas of operating profit margins and return on assets have forced banks to rethink their growth strategies in addition the price earnings ratio has been declining, showing that the market doesn’t have very high confidence in banks ability to grow.

The second reason for the innovation is so important, and maybe the more important reason is that the competition from new players both inside and outside
the traditional banking industry, along with consolidation among the largest banks, as well as commoditization of most of the basic retail banking products and services has forced banks to really try to stand out in the crowd. And innovation is a way for them to do that.

**Kim Hedley:** And in this study, we define innovation as being the use of new ideas or current thinking applied in fundamentally different ways that result in significant change. Can you elaborate on that definition for our listeners?

**John White:** Yes, we see three types of innovation being pursued in the market. The first is product and services innovation. The second is operations innovation. And the third is business and enterprise model innovation.

And let me give you a few examples of each of those. Product and service innovation, which is the most popular, most widely pursued innovation focuses on developing new products and services or targeting new markets and audiences. One example of that would be Wells Fargo’s My Spending Report, which is an automatic online display of all the customer’s transactions from all their accounts with Wells Fargo. This has been very successful and has been used by 25 percent of all Wells Fargo’s clients within six weeks of its launch, a very high adoption rate.

Another one that you may have seen advertised is Bank of America’s Keep the Change program. Well, that program rounds up purchases that are made with the Bank of America debit card or check card to the nearest dollar. And it takes the money from the customer’s checking account and puts it in his or her savings account.

So, it’s really a way of taking your own money and putting it into another account, but it’s a way to help you put aside some money. This has been wildly successful, adopted by 2 million customers and they credit it with helping them to open 800,000 new savings accounts and 500,000 new checking accounts.

So, product and service innovations have provide banks with the opportunity to make a splash and get some real traction with existing customers and attract new customers.

Another kind of innovation is operations innovation where we’re talking about improving the effectiveness and efficiency of core functional areas in the bank. One example is Royal Bank of Scotland or RBS what they call their “engine room”, which is a single back office they have for all their operating groups within the bank. And they’ve been able to increase their efficiency tremendously and going from a cost income ratio of just over 58 percent in 1996 to 42 percent in 2005.
And in fact, they’ve been so effective that they’ve been able to offer this service as a white label service to other financial institutions, so they’ve been able to start another business out of this innovation. Another operations innovator is ICICI Bank from India. And they’ve been doing in-sourcing, they have a very low cost high tech back office in India and they’ve been using that to expand their footprint into Canada and the U.K. where they’ve been targeting Indian populations in those countries and are now expanding their target base.

The third kind of innovation that we see is business and enterprise model innovation where banks refocus, restructure and extend their enterprise. And one example of this is Standard Bank of South Africa, with their Mobile Money initiative.

Standard Bank partners with a cell phone provider, MTN, in order to provide mobile accounts to customers. This is now the effect of expanding their customer base into under-banked customers that may not live in urban areas, may not have access to branches. And their uptake by new customers is greatly exceeded their target and has launched multiple imitators, both in South Africa and in other countries.

Another example is HSBC, they’re an example of adaptation and localization. HSBC has been able to gain 125 million customers in 76 countries by their strategy of business model adaptation around the world. They take HSBC’s brand, HSBC’s standards and procedures and place those into host countries and have a flexible enough business model so that they can adapt to local customs and local ways of doing business.

Now, all of these innovations bring benefits to banks, but we see business model innovation as bringing the greatest and most sustainable return. This factor is recognized by the CEOs that were surveyed by IBM. But, most banks and in fact most companies in most industries continue to focus mainly on product and service innovation.

**Kim Hedley:** So, in light of this discussion then, do you have any tips or recommendations for banks that are interested in pursuing innovation?

**John White:** Yes, I do. Innovation depends on being able to bring together capabilities with a market opportunity. These capabilities might be technology or expertise. The market opportunity is new customers, new markets, or even with rival institutions. But, these things don’t just happen by themselves. Innovation requires the creation and management of an innovation infrastructure that will encourage, reward new ideas and will manage and maintain a portfolio of innovation investments and initiatives over time.
So, banks need to be able to make the investment and sustain the environment and the culture of innovation. And they also need to be willing to fail, because not all innovations are going to succeed. And so, banks need to consider that and plan on that happening. There are a few success factors that we see all innovations in banking sharing, regardless of the type.

They need to focus on innovation that matches well-defined strategic priorities of the entire bank.

The second is that they need to have a vision for success and they need a couple of that bold vision with smaller pilot projects so they can gain experience and build support for change across the bank.

Also, they need to measure and monitor results on a regular basis in order to ensure that they maintain world class performance levels. Lastly it requires senior leadership, banks need to be able to build and maintain support for development and implementation of innovation over a sustained period.

Kim Hedley: John, thank you for your thoughts today. And if our listeners are interested in obtaining a copy of the “Dare to be different: Why banking innovation matters now” white paper, please visit www.ibm.com/services/bcs/iibv.