Post crisis, innovation will rule

You may pick up share from weak competitors now, but soon you'll need more of an edge. Five organizations demonstrate the power of technology to spur innovation

Many industry analysts, including myself, have suggested that smaller banks stand to gain share from larger banks during the financial crisis as customers seek alternatives they consider safer and more reliable. In fact, many regional and community banks are picking up market share already, and deposit and commercial loan growth are fairly robust at many regional and community banks across the country. In the long term, however, banks will need to do more than capitalize on customer attrition from weakened competitors and the movement of funds out of the stock market. Those banks that hope to emerge in positions of strength will need to be able to increase share in the short term while also coming up with innovative ideas to sustain future earnings growth.

Innovation is a challenge for most banks, perhaps especially for those banks with long histories of conservative management— histories that are serving them well in the current crisis. The controls and procedures put in place at banks to manage to safety and soundness objectives can also serve to stifle the innovation process. The message is not to dismantle needed controls, of course. Rather it is to recognize the importance of innovation, and figure out how to make it of equal importance with controls in a bank's culture.

There are valuable insights to be gained in that process by studying how truly innovative companies make innovation happen. In March, *Fast Company* released its list of the 50 most innovative companies in the world. A look into 2009's top five companies reveals concepts that have direct applicability to banking. Notable is that no financial institutions made the top 50.

#1 TEAM OBAMA Whatever one's political persuasion, it's impossible not to be impressed with what Team Obama accomplished. The campaign team relied on technology to connect with voters in ways and with results never before seen. The online community of campaigners that elected Obama "raised more money, held more events, made more phone calls, shared more videos, and offered more policy suggestions than any in history," according to *Fast Company*. Team Obama created an energized and loyal base–something that every bank marketer dreams of creating.

But just how did they do it? Two things are worth commenting on. Firstly, they tapped into the power of social networks, including Facebook and MySpace, to drive an incredibly high number of very small donations. The internet works wonders as a distribution channel for low-dollar accounts. Secondly, this linkage into existing social networks enabled the team to "personalize" the internet donation experience.

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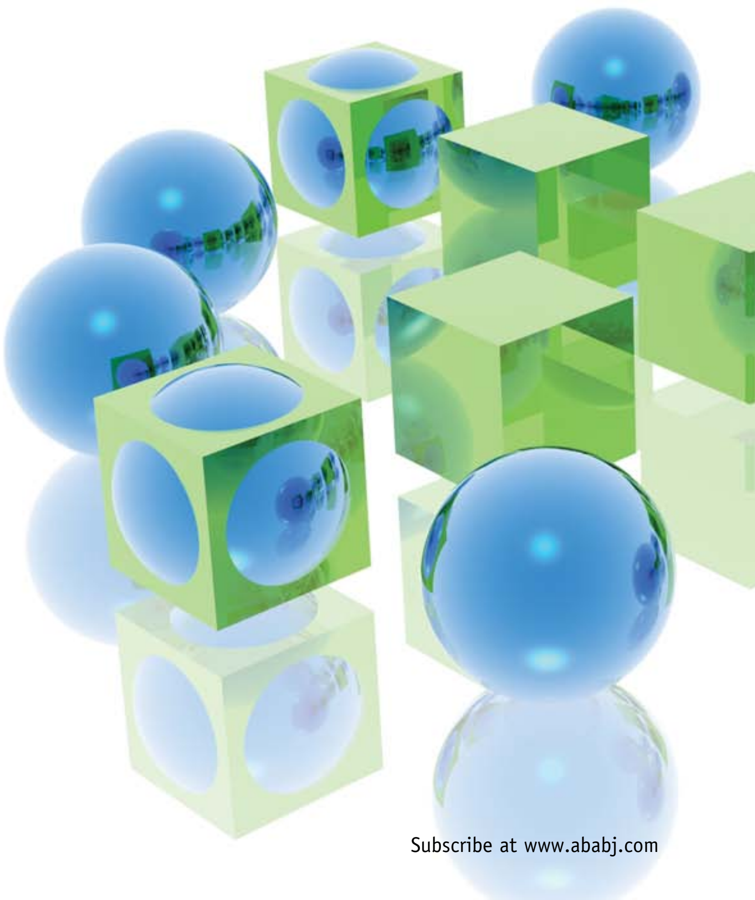
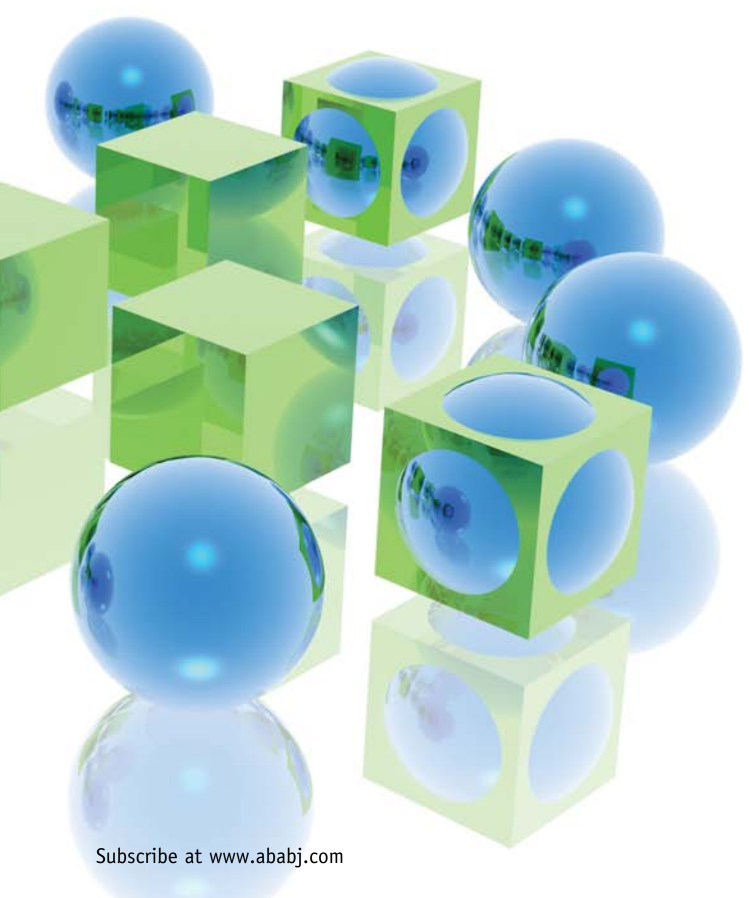


The power of the connected community was on display like never before and the take-aways for bank managers should be many. In the future, the definition of community will need to expand as Generation Y redefines the playing field for banks. Any bank working to figure out how best to leverage social media technologies to build and reinforce their value propositions would do well to study Team Obama.

#2 GOOGLE At Google, everything about the company is designed to identify and foster new ideas. The Googleplex—what you and I would refer to as an office—is designed to be a stimulating and comfortable environment for thinking, interacting with others, and a host of other things that Google believes foster "ideation." Once ideas hit the Top 100 list and are in development mode, they often spend time in Google Labs–where users can test new ideas and help Google to improve them before they are launched. This conceive-spec-design-build-test culture, with users engaged actively in the development cycle, has made Google into a machine for innovation with as many as 60 new ideas in development mode at any one time.

If Google teaches us one thing, it's this: users can help a company to build better products. Apple (#4 below) also actively engages others in its product development process through its open source iPhone/iTouch web applications. The old way of developing products within most banks, with a reliance on a small portion of the employee base for virtually all new ideas and the use of focus groups of potential users for feedback, has led to an industry with low levels of innovation and slow-paced development cycles. It's time for the process by which most banks innovate to change radically. Recognizing this seems all the more important now. As weaker banks become more preoccupied with regulatory compliance and cost control issues and research and development budgets are cut, stronger banks that are in a position to develop more innovative solutions for their clients stand to benefit from their competition's inward focus.



#3 HULU Hulu places in *Fast Company*'s top 5 most innovative companies because of its potential for disrupting the tried-and-true formula of family entertainment: watching television. For anyone who is not familiar with Hulu, it's the website that enables people to watch television programming over the internet.

Hulu began as a joint venture between Fox and NBC, proving that sometimes it makes sense for rivals to work together and beat others to building solutions that threaten their business models. This venture worked early on because Fox and NBC essentially left the Hulu team alone, allowing them to operate like a stand-alone company. Hulu had the potential to leap into the minds of the mainstream American consumers when its content became available for viewing on television sets via a device called Boxee. Just when it looked like this might happen, the networks jumped in and demanded that Boxee remove Hulu content from its service. Old business models die hard.

In every industry, it's worth considering on a regular basis which technology developments have the potential to disrupt or even doom traditional business models—and to consider how best to get out in front of them. Some technology-inspired developments with the potential to disrupt the traditional banking model of taking deposits and making loans include social media sites (Facebook), financial management solutions (*mint.com*), microfinance providers (Grameen), peer-to-peer lending (Prosper), and hedge funds and other alternative providers of capital.

#4 APPLE "Think Different"—Apple's longtime slogan—fits the company to a tee. Apple's innovations are many and well documented. Apple's stores are a particularly good example. There's absolutely nothing similar between the experience of buying an Apple product in an Apple store and a PC/Microsoft product in a big box retail store.

There are some banks that have created different store experiences for their customers, including Umpqua Bank in Oregon (*ABABJ,* October 2008) and Deutsche Bank throughout Europe. For these banks, technology plays a central role in making products and services more tangible, banking more interesting and fun, and stores more engaging. But for many banks, store design remains rooted firmly in the past.

#5 CISCO SYSTEMS Cisco Systems is one the biggest companies in the world, employing over 67,000 people.

ASPIRIN *continues from page 17*

Remedy 2

Southern savings association, reporting on a recent Office of Thrift Supervision exam.

In my bank's examination, the commercial review targeted concentrations of loans. Then the team focused the exam on the higher concentration areas, primarily commercial real estate. Underwriting was a focus, with credit documentation, appraisals/and appraisal reviews, and current financial statements of primary concern. Classified assets, and loans that were not in that classification and should have been, were noted. The Allowance for Loan Losses as it related to Classified assets was also a priority.

The examination was first to establish the creditability of the borrower—sources of repayment, subordinate debt of borrower, and cash flow of borrower.

Dates of financials, including financial statement, tax returns, etc., was important. Check your underwriting! Examiners spent a lot of time reviewing appraisals, concentrations in subdivisions on spec and land loans, and repayment abilities. The team did not seem to care much about over-collateralization if borrower didn't independently pass muster.

There was a willingness to listen to management, but the team still noted loans in exam report. Also, the team was interested in total loan classifications to total capital (CRE in excess of three times capital) and in loans classified as exceptions to policy. ***BJ***

Tech topics

How does a company this big stay innovative? The answer, it seems, involves giving individual business units the freedom and flexibility to act like start-ups. Cisco's Emerging Technologies Group, for example, came up with an innovative approach to innovating: running a contest that pays a $250,000 prize to attract great ideas from outside the company. To date, eight ideas have been turned into reality at Cisco, and these ideas each generate over $1 billion in annual revenue.

"We would never do that"

Years ago, my firm worked with one of the largest banks in the U.S. to develop an innovative approach to meeting financial (and other) needs of the growing seniors segment. The idea was so markedly different from what the bank did in its traditional business model that we recommended to bank management that they charter a new banking company and manage it completely outside the existing bank in order to ensure it could stay innovative and flexible. In one meeting to review the concept, an executive of the bank commented that "this bank would never do something like that."

Our team was flabbergasted. There was no way the new business would work unless it was allowed to brainstorm, throw some ideas out and test others quickly, engage customers and others in the community in new ways, and structure its own alliances and partnerships. Things traditional banks struggle to do.

Starbuck's "my starbuck's idea" *(http://mystarbucksidea.force.com/ideaHome)* is perhaps one of the most active community idea collection sites up and running today. Some banks are beginning to experiment with new approaches to ideation like it, but examples of reaching outside a company to a broader community of "idea developers" hasn't caught on in financial services, at least not in the U.S. In Canada, RBC is in year two of its Next Great Innovator competition in which teams of college students are challenged to submit ideas for the chance to win a $20,000 first place prize. Teams with winning ideas present directly to the bank's executive team, and the ideas are moved into development at the bank. This type of ideation and collaboration, enabled by the internet, is in its infancy today, but it's the wave of the future. ***BJ***