

Viewpoint: Don't Suppress Innovation

By Mary Beth Sullivan

How important is innovation to the business of banking today? The government appears to believe that financial innovations are at least partly to blame for the recent economic crisis, and to some degree this is true. Were it not for powerful secondary markets and instruments like mortgage-backed securities and CDOs, we may well have avoided the real estate bubble in the first place, leaving nothing to burst.

However, innovation in financial services should remain a high priority in the U.S., particularly in light of the changing environment in which banks must now operate.

If the changes, in particular those in consumer behavior, technology and regulation, were incremental, not monumental, and happening on a manageable, predictable timetable, then small, incremental adjustments to strategy, products, and distribution capabilities would be sufficient.

Unfortunately, the changes impacting the banking industry are of such a large scale and moving at such a rapid pace that innovative solutions are badly needed to ensure a bright future for the U.S. banking industry.

Let's consider just one of the forces of change. Consumer behavior is shifting in ways that will redefine how people and businesses shop for, purchase and use financial products. Consumers have switched to a focus on savings and liquidity, away from the spending and investing mentality that drove product innovation in the past. These same consumers now need new approaches to rebuilding retirement savings and better managing personal finances. In addition, consumer mobility is driving the demand

for real-time delivery of information and the disenfranchising of middlemen in the information equation (search engines being replaced by mobile apps, for example), yet very few banks in the U.S. offer any form of mobile banking. These and other shifts in consumer behavior are generating a very real need for new services and new ways of reaching customers, which implies a need for banks to invest in new capabilities.

Enter the federal government.

The Senate Banking Committee has approved a financial reform bill intended in part to prevent future financial meltdowns, even though most banks had nothing to do with the recent crisis. This new regulatory world order will enable oversight of nonbanks that pose great risk to the overall U.S. financial system — and that's a good thing. However, it will also drive down industry profitability as compliance costs rise and revenues associated with consumer credit, NSF/OD fees, trading and other sources of historically significant revenue run dry. The timing of this assault on bank earnings couldn't be more troubling. Lower profitability levels aren't likely to encourage many banks to increase investment in the innovative solutions that are essential to be competitive down the road.

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