

Progressing Financial Markets

PFM02 – Innovation

With James Gardner, Head of Innovation and Research at Lloyds TSB

Announcer: [0:01] Voices in Business presents: Progressing Financial Markets, a podcast sponsored by IBM.

Episode 2: “Innovation” with James Gardner, Head of Innovation and Research at Lloyds TSB

[music]

Mike : [0:20] Hello and welcome to this episode of “Progressing Financial Markets”, a podcast series brought to you by Voices in Business and sponsored by IBM.

My name is Mike O'Hara of Voices in Business and I am joined today by co-host Suzanne Duncan, who is the financial markets industry leader at IBM's Institute for Business Value. Good afternoon, Suzanne.

Suzanne Duncan: [0:38] Good afternoon.

Mike: [0:39] And I would like to extend a very warm welcome to our featured guest on this episode, James Gardner, who is Head of Innovation and Research at Lloyds TSB, the UK's largest retail bank, can I say that?

James Gardner: [0:50] [laughs] Yes, you can.

Mike: [0:52] Good, good. OK, well prior to joining Lloyd's TSB in April 2007, James was Worldwide Director of Retail Banking at Getronics and before that he headed the Financial Services Industry Group at Microsoft, Australia.

At Lloyd's TSB, James is overall responsible for managing the innovation process. He has recently written a book entitled "Innovation and the Future Proof Bank," which will be published by Wiley in the first half of 2009.

He is a prolific and widely read blogger with his blog BankerVision and a regular contributor to industry journals and conferences worldwide. James, thank you very much for joining us and welcome to the show.

James: [1:24] It is a real pleasure to be here.

Mike: [1:26] Great. Now, I'd like to start maybe by looking at the relationship between innovation and risk. The banking and financial services industry has been facing some

very testing times recently and innovation while generally regarded as a positive thing, can bring about new and potentially unforeseen risks. So I guess my first question is how can a bank or financial services firm go about comprehensively assessing the potential risks of any new innovation?

James: [1:54] So, it can indeed be challenging when you are doing things which are genuinely new to actually have an assessment in advance of exactly what the total portfolio of risk might be given whatever it is that you are doing. The general answer is that you have to start at relatively small and taste-test a little bit before you do anything very substantive. And I think that most institutions around the world have been very good at doing that as a general rule.

Mike: [2:22] Suzanne?

Suzanne: [2:24] Yeah, I have a question just regarding innovation, how would you define innovation and you can think about risk as being a lens, but first maybe start off with a definition of innovation and then to talk about some of the potential risks and how you would assess them in each of the different categories because we are assuming that innovation could be bucketed into a few different types of innovation?

James: [2:44] That's absolutely correct and my own definition and the one that my institution tends to follow is that for us, innovation is anything that we are presently not doing at this moment. So for most people, they imagine that innovation is something that is genuinely new to market. We don't necessarily take that view. If it is something new to us or something that we haven't tried yet, then we would probably consider that to be innovative.

We'd probably classify innovation, not by how genuinely new it is, but by the area in which it affects. So we would, for example, investigate product innovations or experience innovations, business model innovations and a range of other types, which go to the way we do our business.

Suzanne: [3:30] And just a follow-up question to that if I could, when we have been conducting interviews, we have got about 130 or so interviews so far as part of our current research study and we have been all across the different geographies within financial services. And we have asked the question at the end of every interview, what keeps you awake at night? Eighty percent of executives say one thing: they say "business model innovation."

They know that they need to do this and they are a little bit uncertain as to how and this is all a direct result of the credit crisis. So I guess the first question is, would you agree with that thinking that this could potentially be an inflection point in the industry and if so, how do you think the nature of innovation may change due to the credit crisis?

James: [4:15] It is very interesting to me, all of this focus that seems to have suddenly happened on business model innovation and perhaps institutions haven't been known, necessarily externally for business model innovation in the past, but I think that it is not a new thing that institutions try to be creative and innovative in the way they do their

businesses and maybe the focus of the current market conditions have shed light on this. But certainly, we imagine that business model innovation is certainly one of the areas in which the most threat will come in the future.

In the research I did for future proofing, it turned out for me also as I think it did here at the Institute for Business Value, that business model innovation is indeed the area in which we can expect the most threat for the future. And I guess the important thing for institutions is to be systematic about how innovators and innovation programs go about dealing with that and coming up with clever responses which are going to be required in the future.

Mike: [5:14] James, you mentioned future proofing that and this is something that you have written quite extensively about, is the correlation between the performance of banks and their ability to think forward, are there some examples you can share with us of where this forward thinking and future proofing has worked and where it hasn't maybe?

James: [5:34] I think that there are a number of really interesting academic studies that take this point completely. I can't remember the specific reference, but one that I found talked about how CEOs who are forward thinking - and forward thinking is defined in this case by analyzing the public statements these CEOs made around the time that Internet banking was beginning to be something that was important - CEOs that were demonstrated to have a lot of forward thinking characteristics, their institutions generally were much better performers at responding to the innovation of Internet banking. As a general rule, those that had forward-looking CEOs were able to demonstrate much earlier entry to the innovation of Internet banking. And when they did enter Internet banking, their offerings tend to have a much broader future set than otherwise was the case.

I think in the research I have been doing it is rarely the case that structured methods for determining future states are employed. And certainly it seems to me that those institutions, those few institutions I found that do this, seemed to have weathered the crisis in a superior fashion.

Mike: [6:41] Suzanne?

Suzanne: [6:43] How does a bank go about creating a culture of innovation and adding to that question, a little bit more depth, and if you could speak about the different types of innovation, you can think about business model innovation that we have talked about, you could think about product innovation that this industry tends to be very good at, and then speak a little bit about the "how to" part from a people, process, technology standpoint?

James: [7:03] So I think that the whole thing about innovation cultures is a very interesting question. And one thing that I have been looking at quite closely for my book in future proofing is, do you actually want an innovation program comprised of a whole pile of innovators or actually is what you want a culture for innovation just happens by itself? And I think that there are many examples on both sides of the fence on that particular question.

The conclusion I have basically come to is that while you want an innovation culture, which is the situation where everyone feels it is their day job to do new things, a lot of the time these day jobs get in the way of doing that and it can be helpful to have an innovation team or innovation program of some description that actually helps move things along. And certainly that's the approach that has been adopted by my own institution.

The real problem is actually being able to couple the people who have the ideas with the ability to execute those ideas and this is typically a challenge, because some of the very most amazing insights do not come from people that actually have the ability to execute. They may not have the power to execute, they may not have the money, the budget, they may not be in the organization in a place which enables them to execute.

And without that ability to couple the idea plus execution, you really are left in a situation where you are never going to develop an innovation culture. This tends to be a very significant challenge, because a junior who has just entered the business is probably never going to be in a position within the timeframe of an idea to actually do anything about it. And I don't think that there is an easy solution.

Mike: [8:43] What about the measurement though of what any new innovation can bring both on the positive side and going back to the original question about the risks of these new innovations. Surely some of these things are very difficult to measure on both a short-term, medium-term and long-term basis, so how do you go about doing that?

James: [9:01] I was speaking with another institution just yesterday actually about this point and they said to me, "Well James, the only measure that really makes sense is products and patents, those are the only things that count, everything else is just fluff and innovators shouldn't be doing it."

I don't share that view, because there are a number of innovations which do not come to an easy business case. There are innovations for example that results in productivity improvements and it is practically impossible to get to a decent number for a productivity improvement. And even if you do, you have a difficult time convincing your colleagues that the number is a real one, but it is impossible to say that such a innovation isn't worthwhile doing.

So as you get to a worthwhile number, I think you have to have a balance. In my own program, we concentrate firstly on innovations which we can definitely get a number for and then we use those innovations to help us pay for the ones that we can't.

Mike: [9:58] Right. And you must speak to a lot of other innovators at banks as well, is the way that you and your department approaches innovation fairly typical in the banking industry or do other firms have very different ways of going about it?

James: [10:14] I think everyone has their own very different way of measuring the result of innovation. It is especially difficult in financial services I think. Some people don't

bother to measure at all and what you have is innovation programs that result from individual heroics. The person creates the idea, then the person actually gets the idea implemented and the person then chooses to measure it if they need to. That's one extreme.

At the other end, you have these very concrete measures like how many products and how many patents did you develop. And I think that there is everything in between as well.

Mike: [10:47] Any other thoughts on that Suzanne, on that point?

Suzanne: [10:50] A question I guess is related to the technology side of things and I am not sure if you can comment on this, but are there any key types of innovative technologies that you see on the horizon, whether it is related to the credit crisis and helping firms address that or anything else you would like to comment on?

James: [11:07] Well, the first comment I'd make about innovation and technology in financial services I think, is that of all the kinds of innovation we can do, whether that is business model or it is product or market or experience or any of the other sorts that we focus on, inevitably it is the case that underlying those particular innovations there is going to be technology.

It seems in financial service it is impossible to do anything without touching the technology landscape to some degree. And so most innovators that I know spend a lot of time either being technologists or talking to technologists.

As to technology that is innovative, I think that I wouldn't probably make a comment right now on specific technologies, but there is a class of technology, a class of system that is going some way to making the process of innovation more simple.

We are seeing certainly in my own institution relatively rapid adoption of new tools that implement processes and systems that help you get to an easier flowing of idea into something that executes. And I think that the development of innovation science, this process for doing innovation, will be one of the key things that we will expect to see in the next decade.

Mike: [12:19] Do you see a more statistical approach to innovation in the future than maybe you are seeing now?

James: [12:25] Innovation like many kinds of things that financial services companies do is inherently unpredictable in its nature. You don't know who is going to be the little genius that thinks up the next great thing, you don't know when that might occur, but what you do know is if you treat the entire body of ideas and the entire body of execution as a statistical problem, then you can make statements about the likely returns you are going to get. And I think we will see increasing use of models to help us with that.

Mike: [12:58] Is that something that you are personally working on, on those models, is there anything you can tell us about or you are aware of people who are working on those kind of models?

James: [13:05] I think it would be true to say that any institution with a relatively advanced innovation program uses to a greater or lesser degree modeling.

Suzanne: [13:15] So the last question is the one that we ask everyone in interviews, but what keeps you awake at night?

James: [13:21] Well, there are several things that do. One of the challenges as an innovator is you have a relatively limited runway in which to demonstrate results. And the runway tends to get shorter in times where things are difficult and you have a bit more runway in times when things are good.

The runway tends to come in multiple levels, so once you have achieved success in one level, perhaps for example you have gotten past innovation heroics and now you are predictable and you can produce a return year on year, the next level after that is can you future cast and each time you have this level of runway, so what keeps me awake at night is that we will run out of runway before we get to the right next level.

Suzanne: [14:10] Right, that makes sense. Well thank you, this has been fantastic.

Mike: [14:13] Well James before we wrap things up, can you tell listeners where to find your blog?

James: [14:19] So, I write at the following URL, it is www.bankervision.typepad.com.

Mike: [14:25] OK. And maybe just tell us couple of words about some of the things that you cover on that blog.

James: [14:30] Yeah, I mainly write about innovation and banking trends. I am particularly interested in how innovation is done in banks and I write extensively on that. You touched a little bit on some of the things I talk about. I am very, very interested in predicting the way innovation programs work using models and statistics.

I care about banking trends and things which are potentially very, very disruptive to banks. There is an increasing number of disruptions I believe on the horizon, especially for retail banking and the result of that is that I spent a lot of time in my own innovation program and on my blog talking about the ways that innovators ought to accommodate those things for the future.

Mike: [15:10] And that blog is open to comments and input from other people who are involved in the industry and innovation and so on as well, in fact you got quite a social network going on there I think?

James: [15:21] Oh it has been an amazing tool. It has enabled us at my institution to reach out to innovators all around the world and I think that it has been very valuable for my own development and the program's development to be able to do that.

Mike: [15:32] Great. Well, thank you, James. We will put a link to that blog in the show notes of the podcast at ProgressingFinancialMarkets.com. Quick words to our listeners: if you enjoyed this program and would like to be automatically notified as and when new episodes are released, then go along to that website. I will give you the URL again, it is www.progressingfinancialmarkets.com.

And if you click on the "how to subscribe" link on the right hand side of the page, you will see instructions on how to be notified either by email or how to subscribe to the RSS feed or how to automatically receive each new episode using iTunes. So that's about it for this episode. James, thank you very much for coming along today and sharing your thoughts with us.

James: It is a real pleasure.

Mike: Suzanne, thank you for joining us all the way from Boston.

Suzanne: Thank you very much.

Mike: And from me, Mike O'Hara, thanks for listening and, until next time, goodbye.

Announcer: [16:20] Progressing Financial Markets was brought to you today by Voices in Business, helping our sponsors to achieve thought leadership in their business sectors. To find out more about what we offer, visit www.VoicesInBusiness.com. Thanks for listening. Goodbye. [music]