Digital Financial Innovation Is The Antidote To Disruption

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Digital Innovation Is The Only Way To Outflank Your Competitors

In the past decade, financial services firms have embraced digital technologies, rolling out products and services across digital touchpoints. But that's no longer enough because the goalposts are constantly moving:

› **Consumers' digital expectations are rising.** Many of your customers are also the customers of Amazon, Netflix, and Zappos. These companies continuously exploit digital technologies to delight their customers, resetting consumer expectations in the process. If you think your customers will give you a pass because of security and privacy concerns, think again. The rise of firms like PayPal shows that consumers will happily adopt financial alternatives enabled by digital technologies if those fulfill their unmet needs or deliver additional value. And every year, a new cohort of digital natives is raising the expectations of your customer base.

› **Hundreds of ambitious and agile financial upstarts are bent on meeting those expectations.** Firms like Square, Lending Club, and TransferWise are chasing after your customers with better, cheaper, or entirely new ways of meeting their financial needs. Unencumbered by legacy technologies and thinking, and bankrolled by venture capital, digital disruptors can afford to innovate fast and furiously. Their innovative digital financial products and services often bypass regulation and undercut incumbents’ business models in the process.
Your competitors have stepped up their innovation efforts. A growing number of leading financial services firms like Axa, BBVA, and Wells Fargo are embracing open innovation, running hackathons, setting up startup incubators and innovation labs, and pouring hundreds of millions of dollars into venture funds. Other firms like Allianz and BNP Paribas Cardif are partnering with telecoms firms and digital platforms to develop new services around the connected home. Beyond improving their offering on laptops and mobile phones, banks and insurers like Akbank and Insurance Australia Group (IAG) are experimenting with emerging technologies like Google Glass and the smart watch. In 2016, 48% of business decision-makers at financial firms identified that increasing the use of innovative technologies is of high or critical priority, adding urgency to innovation.

Focus Your Innovation Efforts On Delivering Value To Your Customers

Innovation as an aim may seem overwhelming, broadly encompassing improvements to products, processes, business models, and organization. It can also be viewed with suspicion by an industry marked by heavy regulation and ingrained risk-aversion. Overcome these obstacles by focusing your energies on digital innovation.

Digital innovation draws on video, voice, proximity, artificial intelligence, social, mobile, and other technologies to deliver customer value. Crucially, it is:

› Customer focused. Financial services disruptors focus obsessively on winning over consumers. To compete, you need to match that obsession. Innovators like Bank Zachodni WBK in Poland, CaixaBank in Spain, and Wells Fargo in the US all use customer value as a filter to decide which innovations they should pursue. Defining the customer value of each innovative project should also make it easier to win your colleagues’ and managers’ support for it.

› Balanced. Technology can be a siren call. It's easy to get lured away by something that is exciting but unreal and risky. To avoid mislaying your resources, focus on the “adjacent possible.” This doesn’t mean that you can’t or shouldn’t invest in ground-breaking initiatives, but make sure that your innovation portfolio is a mix of incremental opportunities like better user experience and a wider range of functionality as well as more experimental ideas like, for example, cryptocurrencies.

› Within your domain. The rapid advancement of the Internet and mobile touchpoints has made eBusiness a hotbed of innovation. And like any other complex processes, innovation requires cross-functional collaboration, not least with your technology management, customer experience, and customer insight colleagues.
A Commitment To Digital Innovation Will Save You From Being Disrupted

Digital innovation may not have an immediate return on investment. But this strategy can still help you.

Incumbents Can Become Innovators But It Won’t Happen In A Day

If you’re a traditional, large, and rigid financial institution, becoming a digital innovator won’t be quick or easy. To be successful, you need to think carefully about how you can best generate, evaluate, incubate, and implement new ideas. The different building blocks of your innovation strategy are likely to require (see Figure 2):

› **A new organizational structure that sparks innovation.** Depending on whether innovation at your firm is stifled by a rigid structure, risk-averse culture, or cumbersome procedures, you may need to re-organize internally to overcome these obstacles
Conscious efforts to develop a more innovative culture. If your organization is like most financial services firms, changing internal culture will be one of your main challenges. You will need to convince your colleagues that innovation matters, and that it’s their job as much as anyone else’s. In particular, you will need to work with some of your most conservative colleagues in areas far removed from customers like compliance, legal, security, and risk.

A set of processes to help generate, prioritize, and implement ideas. From hackathons and digital labs to working in sprints, there are plenty of measures that will help turn good ideas into a portfolio of innovations that deliver business impact.

An external ecosystem of innovation partners. To be financial innovators, digital executives need ideas, data, technology, design experience, and change management support. Many of these components can’t be sourced internally in a time- and cost-effective manner. Partners like design agencies, systems integrators, adjacent companies, startups, and even competitors can help you add capabilities quickly.

New ways of measuring innovation efforts and results. To ensure that you don’t just burn money, you will need new ways of measuring the potential and the success of your initiatives.

FIGURE 2 An Explicit Innovation Strategy Relies On A Number Of Components
Digital Innovation Will Speed Up, Making It More Difficult To Keep Up

Conditions are ripe for digital financial innovation: Consumers are ready, regulators often favor innovation, and the technologies required to transform these industries finally work. Digital upstarts and incumbents alike will channel their energies to get first-to-market advantage in innovative financial products and services. Pushed by disruption of old business models, financial services firms will:

› Get bolder in the chase after digital innovations.
› Divert more money toward incubators, accelerators, and venture funds.
› Drive the business technology (BT) agenda.

Endnotes

1 We reviewed 66 retail banks in developed economies across the globe and found that almost all large banks, and many smaller ones, now offer a range of basic mobile banking functionality, such as access to account balances and recent transactions, through a range of different platforms including mobile-optimized websites and mobile and tablet applications. See the November 24, 2014, “The State Of Mobile Banking, 2014” report.

Insurance companies are also rolling out a widening range of mobile insurance functionality for both consumers and agents. See the July 2, 2014, “The State Of Mobile Insurance, 2014” report.

2 All three companies offer some best-in-class mobile experiences, supporting customers in their cross-channel behavior. People now spend equal amounts of time online on their phones as on their PCs, but in more frequent, shorter increments, and with only partial attention. Successful mobile apps recognize these behaviors and seamlessly guide users in and out of interactions. See the April 4, 2014, “The Best And Worst Of Mobile User Experience” report.

3 Digital businesses continuously exploit digital technologies to both create new sources of value for customers and increase operational agility in service of customers. See the March 10, 2014, “The Future Of Business Is Digital” report.

4 Digital disruption has arrived in retail financial services. Banks, insurers, and wealth management firms are besieged by a wave of disruptors that aim to use digital tools to deliver superior customer experiences at a fraction of the cost. See the July 16, 2014, “Digital Disruption Hits Retail Financial Services” report.

5 Encouraged by the early success of some disruptors and drawn by the incumbent firms’ high margins and failure to capitalize on digital technology, venture capital is now flowing into digital investing startups after years of dormancy. Social investing startup Motif Investing, for example, has raised $86 million. Digital financial advice platforms Learnvest and Personal Capital have raised $69 million and $54 million, respectively. The disruptors will use this money to create new sources of value for customers and to raise awareness of their offerings. See the November 14, 2014, “Digital Disruption Threatens Wealth And Asset Management” report.

6 Digital technology has enabled new business models that often bypass regulation altogether. Many disruptors, such as social lending platforms or digital money managers, are just enablers: They don’t hold capital but connect people who have money to invest with those in need of funds, or use existing transaction data from banks to offer customers help with budgeting. Without the burden of capital requirements or regulation, these businesses are quick to set up, cost-efficient, and more agile.


Over 2013 and 2014, Banco de Sabadell and CaixaBank in Spain and Bank Millennium in Poland developed a banking app for Google Glass. In the same period, Akbank in Turkey, Nationwide in the UK, Westpac in New Zealand, Bank Millennium, and CaixaBank launched their applications for the smart watch. IAG in Australia is currently prototyping an app for a smart watch that uses changes in heart rate to improve alertness and attention with the aim of preventing accidents caused by fatigue.

We asked 341 financial services business decision-makers which technology initiatives their IT organization was prioritizing over the next 12 months. Source: Forrester's Business Technographics® Global Priorities And Journey Survey, 2014.

In the context of capital markets, innovation has come to mean a lack of regulation and poorly understood risks. “Innovative” financial investment products like securitized mortgages have contributed significantly to the 2007/2008 financial crisis.

The term “adjacent possible” comes from evolutionary biology. Biology theorist Stuart Kauffman points out the seemingly obvious fact that evolution can only produce its most complex innovations, such as eyeballs and wings, by first experimenting with more adjacent possibilities. By Kauffman’s definition, an adjacent possibility is a stable next stage in evolution or innovation that can act as a segue to the next adjacent possibility. These adjacencies are usually not linear or even obvious. Yet, accumulated over time, they lead to things like sight and flight — some of the biggest innovations ever attempted. See the August 4, 2011, “Innovating The Adjacent Possible” report.

Forrester defines three different types of innovation: chaotic and rapid innovation to address the fastest-paced change; sustained innovation — a robust process for finding and funding new ideas; and strategy-driven annual investments to address well-understood opportunities for which a business plan can be prepared. Digital innovation encompasses all three approaches, and the right strategy is to make a series of innovation investments, building a portfolio that complements the firm’s strategic plan and strategic needs. See the February 12, 2015, “Innovators Will Be The Winners In The Age Of The Customer” report.
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