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Financial Services Innovation: Local Strategy, Management, and Change – A Field Investigation

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This study examines the innovation sources and processes of regional financial services firms through inductive field research. Innovation in these firms, and presumably other financial services firms and other smaller organizations, originate primarily out of three sources, the drive for efficiency, the external environment, and strategic, ambidextrous management. Successfully innovative firms balance the short-term need for efficiency improvements with the long-term desire to grow primarily through visionary, yet adaptive, leadership.

Introduction

Our economy is about ideas, exploration and experimentation – businesspeople imagining new concepts, entrepreneurs engineering new products, and financiers strategically envisioning which innovations to back. Throughout the economy, from manufacturing to technology to education to healthcare, innovation is at the core of successful companies' focus (Phelps & Tilman, 2010). Academics and business professionals believe that, to be successful in this global environment, companies must continually improve and restructure products, services, and operations (Bantel & Jackson, 1989). To win the game of business, companies function in order to provide customers with more value, to respond to new needs with new products, and to integrate new technologies and processes into their models. This means companies must innovate (Dougherty & Bowman, 1995). At the core of this economic growth and focus on innovation lies the critical role financial services firms play, and in order to stay competitive, these institutions must also be at the forefront of industry innovation.

The study of innovation has changed how we think about the practices of successful businesses, how we think about growth in an economy, and how we view the role of business in our lives. Studies in innovation have overwhelmingly focused on technology, manufacturing, and construction firms, where products are tangible and changes are easily observed. Innovation in service-based industries, particularly financial services, has not

been studied at the firm level in nearly as much detail (Thomke, 2003). However, the U.S. financial services sector is an extremely attractive arena for organizational innovation studies due to its complexity and importance (Pennings & Harianto, Technological networking). The industry plays a critical role for business and entrepreneurial growth and also for understanding its innovative processes is essential as firms compete in this environment.

There are several reasons this industry is becoming particularly interesting to researchers within the realm of innovation and management studies. First, many have come to understand how fundamentally different the services sectors can be, making it ripe for research and shifting the focus to service-based industries. According to Thomke (2003), there are very distinct differences between the innovations of services firms and those of manufacturing firms, such as the inability of financial services firms to apply traditional research and development models. Since the product is a service, a specific moment in time in which the firm interacts with a customer, research and development cannot be confined to a laboratory, making it seemingly more difficult to innovate (Thomke, 2003). The best practices in fostering innovation, discovering new products and services, and developing new organizational structures will likely be very different for financial services firms and must be understood by professionals and academics in order for firms to further compete in the market.

Secondly, the sector is rapidly changing, especially as new regulations come into law, the global economy becomes more interconnected, and technology becomes more fundamental to bank operations. While the essential functions performed by the organizations that make up the industry have remained relatively constant over the past several decades, the structure of the industry has undergone dramatic change (Pennings & Harianto, Diffusion of technological innovation). New regulations intend to improve transparency within the industry, mitigate risk in the overall global financial economy, and lessen the degree of financial and accounting fraud; however these new regulations may result in substantial costs for financial services firms. Technological advances are also rapidly changing the landscape for payment processing, credit card transactions, fraud detection, and other functions; thus the costs of traditional banking functions are falling (Phelps & Tilman, 2010). Banks and other institutions continue to struggle with the losses from the financial crisis and are becoming more and more interconnected (Bonaccorsi di Patti & Gobbi, 2007). The need for innovation at the firm level is essential as the structure of the financial services sector changes and develops over the next several decades. The future market structure of banks will reflect the ability of each firm to develop and exploit various advantages, build on acquired skills, and learn from others (Aliber, 1987).

Understanding the innovation processes in the financial services industry will likely result in a better understanding of how the financial services industry can adopt the best practices, stay competitive, and meet the changes posed in today's economic climate. This research project intends on determining how financial services firms collect novel ideas on new products and services, how financial services firms can better foster innovation and adopt best practices, and how these firms can balance potentially conflicting innovation models.

As broad, diverse, and complex as the financial services sector may be, this paper simply focuses on innovation in regional financial services firms, which allows for a closer investigation of some of the topics of interest. In other words, this report concentrates on small changes that are related to process improvement, new products, new marketing schemes, new organizational structures, and the complex combination and balance of these innovation initiatives within an institution in a smaller, regional area. As interesting as other

topics may be, this study does not include the changing adaptation to regulations or the emergence of new financial products in the economy as a whole. This study has a primary focus on the innovation processes and connections within these individual, smaller firms.

This paper, firstly, reviews some of the literature on innovation and models of innovation in different types of firms; secondly, references the field investigation and methods in which some of the theory can be supported; and thirdly, draws some conclusions, using past research and the field investigations. This research finds that efficiency is a key driver of innovation as companies seek to solve problems in operations, improve processes, and leverage available technology. Another key to strong innovation is that of the connection and adaptability to the external environment. The most effective managers and executives interact with others in the industry, learn from publications, use external consultants and resources, and seek out the information needed to execute a project. The third source of innovation involves complex visionary leadership in these firms. Effective leaders understand the critical balance between short-term efficiency and exploitation of resources and the long-term strategic goals of exploring new ideas, products, markets, and customers.

This study finds that financial services firms act ambidextrously, balancing the short-term need for efficiency and the long-term desire to grow and adapt best practices. Firms in the industry put this into action through visionary upper-management.

Literature Review

Organizational researchers do not yet agree on a single definition of innovation. According to many researchers, innovation can be described three different ways: innovation as a process of improvement; innovation in discrete terms, including product or service improvements; and innovation as an attribute of organizational structure. When an organization is described as “innovative,” it generally means that the firm consistently develops new, dynamic products, programs, or services for its own use or customer and client usage. Simply put, the innovation process culminates with innovative products or results, and firms that cycle through the innovation process often are described as innovative (Bantel & Jackson, 1989).

A product is the good or service offered to a client, and product innovation is a new product or service that creates additional value for customers. A process is the mode of production and delivery of the good or service, and process innovation can be described as the new elements introduced into a firm’s production or service operations. Both product and process innovations can be described as “radical” if the outcome is completely new or “incremental” if the result represents an improvement over an existing process or product (Dougherty, 1992). The literature also makes the distinction between “technical innovations,” referring to the design and delivery of products and services, marketing and operations, and “administrative innovations,” referring to innovations related to general management issues, such as staffing, strategic planning, and training programs (Bantel & Jackson, 1989).

Beyond defining and understanding what innovation is, there are several different ways of understanding innovation in the context of a firm, what it means to a firm, and how firms exploit and explore different options. Another good way in which to understand product innovation, used by many researchers, is to think of it as a complex process of problem solving, which requires three different activities. One activity entails conceptualizing the product design fully, and then bringing this design into existence. Another activity concerns organizing the work to coordinate across functions, laterally integrating different

functions within the firm in order to maximize creativity and exploit different ideas. The third activity consists of linking the product to the firm's resources, structure, and strategy, which confirms that the innovation is feasible, fits into the firm's operational functions, and can become a part of the firm's overall strategy (Dougherty & Bowman, 1995).

Three streams of understanding are also available for those wishing to delve further into the research field of management and innovation. The first stream of understanding innovation is what Pfeffer and Salancik (2003) call "resource dependence." In this view, managers lack the power to do anything other than to allocate resources to innovative programs that are required of the firm by external customers and investors; thus, these managers are dependent on environmental resources. The second stream of ideas, taught by Christensen and Bower (1996), describes the resource allocation process internal to the firm, suggesting that most strategic proposals or new products and processes take their shape at lower levels of hierarchical organizations, giving the firm power over their innovative processes. Thirdly, according to Pennings and Harianto (Technological networking), innovations in organization are generated from the skills and competencies that a firm has accumulated throughout its past. A firm's stock of skills, talents, resources, and competencies evolve from its past experiences and accomplishments, and thus innovation is a developmental and ongoing phenomenon (Pennings & Harianto, Technological networking).

As mentioned, traditional innovation literature would suggest that organizations innovate by getting new and improved products to market, and this is the same in financial services. However, in a service, the product is the process, because the product given to customers comes from a process internal to the firm. Thus, innovation in banking lies more in process and organizational changes than in traditional product development (Pennings & Harianto, Diffusion of technological innovation). Since the early twenty-first century, many researchers took these concepts and models and began to apply them to more process innovations and to fewer product innovations, given the growth and complex nature of these service sectors. The focus is further put on process innovations since service organizations and the banking industry in particular do not patent their innovations and tangible products are easily replicable by competitors (Marabelli, Frigerio & Rajola, 2012).

Understanding innovation descriptions, innovation and management research theories, and some of the models used in all industries is critical as research attempts to understand financial services firms specifically.

Methods

This research project builds on the previous models and research in innovation, but focuses solely on innovations in financial services firms. In other words, this project concentrates on small changes that are related to process improvement, new products, new marketing schemes, new organizational structures, and the complex combination and balance of these strategic initiatives. This has been done through in-depth, inductive interviews with executives, managers, and presidents of credit unions, banks, and trust companies. These seven in-depth interviews involve open-ended questions with the goal of delving into the subject of innovation in order to sift out themes at the firm level. This research received Institutional Review Board approval by UT's Office of Research before any interviews were conducted (this document is available from the author), and each of the interviews was transcribed within twenty-four hours of the original field visit. Interview details are as follows, including the length of each interview and the titles of the individuals; names of interviewees and bank names have been concealed.

Company	Title	Length of Interview
Regional Bank	Chief Executive Officer	70 minutes
Regional Bank	Chief Financial Officer	60 minutes
Regional Bank	Chief Operating Officer	90 minutes
Credit Union	Vice President	60 minutes
Trust Company	Chief Executive Officer	75 minutes
Startup Bank	Chief Development Officer	60 minutes
Startup Bank	Operating	75 minutes

The seven interviews, classified as fieldwork research, typically included eight to ten very open-ended questions and lengthy responses centered on individual projects, initiatives, strategies, and process improvements. The fieldwork was conducted over a five month period, and each participant was contacted primarily through personal connections. The following questions highlight some of the main discussion topics, though each interview varied drastically and questions changed for different organizations and participants.

Questions for Interviewees

- What is the last change/innovation/new product that your firm has developed/offered?
- What is the next project/innovation that your firm is pursuing?
- What is your role in the development of new ideas and innovation?
- Where did the idea or innovation originate?
- What is the biggest challenge to getting new ideas implemented, or why does your firm struggle to implement change?

During the interviews, several themes became apparent. To ensure consistency of the findings, reviewing the interviews included writing thorough notes in the margins to determine if the same themes were found across all organizations. Below are the key themes that emerged from all institutions. These themes were mentioned in at least six of the seven interviews and were on the front of each participant's mind in regards to the function of the organization. Each theme is derived from full discussions with managers, executives, and vice presidents on the topics.

Major Themes for Financial Services Innovation

Financial Services Firms' Drive for Efficiency

The first and one of the most prominent themes which has emerged from the interviews centered on the constant need for efficiency. Financial services organizations provide products which act very similar to commodities, and customers have very little switching costs between one provider and another, thus there is a constant need to improve efficiency across all functions and solve process related issues. The theme to improve efficiency through process improvement was identified in all four organizations and was mentioned approximately twenty-five times across all interviews. The Chief Executive Officer at Regional Bank states:

"Deposits are really becoming more and more commoditized. There is a lot of pressure on rates, and people can go anywhere for a CD. We need to cut costs in a big way and figure out how to get more customers."

Thus as subtly stated above, a bank with a streamlined process, the latest technology, or the ability to cut costs has a significant advantage.

As discovered, much of the new innovations in financial services firms center on the need to provide faster or less expensive service to the customers. The need to be lean, efficient, and cost effective is at the core of what innovators in financial services are aiming to do, and it was a thoroughly discussed topic. The best and most innovative firms can excel at identifying the inefficiencies within a process and finding the best solutions to issues. Innovation is, at its core, the complex process of problem solving as previously mentioned. This Chief Executive Officer continues by saying:

“You have to be open to exploring new ways of doing things and becoming more efficient. One of our efforts is to become more efficient and greener.”

This banker at Regional Bank was very concerned, in particular, about the costs of printing agendas and information for meetings, including detailed board meetings in which a single participant may have up to one hundred pages of printed notes. To solve this, the bank soon installed projection screens and other electronic devices and distributed handheld tablets to meeting participants in order to save time and money on printing information. The Chief Executive Officer continues:

“All of our board meetings are now completely electronic. We now scan reports. We installed computers into the meeting areas. We use touchscreens to give the presentations now. This saves a lot of money because it took so much paper to hold meetings before. It took a lot of time to scan and print those papers as well. Going green was a matter of understanding the possibilities and understanding the cost savings.”

This is a great example in which an organization, and its leader, were constrained by resources, time, and cost, and were thus forced to find a solution to a problem in the form of a new innovation.

As observed, much of the innovative activities from financial institutions originate from the need to solve a problem or a potential cost savings. The Chief Operating Officer of the same Regional Bank saw an issue with the bank’s budgeting system, an administrative issue, and saw the need for a change:

“Our budget is a recent change that we made as well. There initially wasn’t one at all until my team started developing one for the entire bank. But we eventually moved into a model that allowed each department to do their own budget. It was a necessary change. It became a lot more accurate, and each department developed a sense of ownership over its own spending.”

Since efficiency is the goal with many, if not all, of the ongoing projects in financial services firms, the need to make processes faster and cheaper is integrated with the organizations’ desire to grow the business. Many changes in these organizations, such as a new reporting system, the implementation of new devices in which to communicate with clients, or the decision to outsource a particular function, emerge from the desire to continue improving efficiency while the organization is rapidly growing, especially into new markets. The following banker, the Chief Development Officer of Startup Bank, notes how the organization

could not service loan applications with the clarity and speed as in the past once the bank began growing. He states:

“Well, we knew we needed a new loan application process because the volume of work was growing so fast. There was a lot of inefficiency when the bank was growing rapidly. We just had to ask ourselves if there was a better way of doing it. We basically just changed over to an all electronic process and created a faster, better way of processing loan applications. With this, we have an electronic file system so a file can be sent through the organization, to different employees and officers, very quickly and through a step-by-step process. People now know exactly what to do and where a document goes after he or she reviews it. This helps a lot when moving locations or growing the organization.”

The Chief Financial Officer of Regional Bank notes the importance of thinking about efficiency even before the bank grows and attains new business:

“One of our goals, especially in my department of finance, is to be very scalable when we start growing. Since we want to grow and be very lean and quick to respond in the future, we need to make steps to be scalable and efficient now.”

This banker also states the need for technological advances as the bank grows and serves more customers; however the use of technology can also be limited to the knowledge base of the executives and management team. The Chief Financial Officer of Regional Bank was concerned about organizational structure and the actual implementation of new processes:

“The goal of technology is to be able to do it well. It needs to be used in a way that we can scale up as we continue growing.”

It is also interesting to note that a lot of upfront research, cost analysis, and planning has been performed even on a simple project in a smaller organization. Also, most of these efforts to cut costs and “find a better way” come in the form of process improvement combined with technology improvement. Many of the current projects in banking and financial services are the result of an increasing technological ability and the need to streamline processes and cut costs. The following banker, the Chief Operating Officer of Startup Bank, reflects on a new electronic check clearing system that has allowed the bank to process checks and deposits much faster and provide an additional convenience to customers. He details:

“Now, as we’ve grown, only about 15% of our deposits are deposited traditionally. There is a clear cost and clearance advantage and it is much better for our model. It is cheaper to do this electronically, it is faster, it doesn’t take up our employees’ time, and it has been easier to set up processes electronically than with physical documents and checks. It is a great example of something that probably would have happened anyway to solve a lot of problems and inefficiencies.”

This Chief Operating Officer has obviously used technology to solve problems of inefficiency within the organization. Processes have been streamlined, and costs have been minimized.

Innovation and the drive for more efficiency are sometimes out of the realm of feasibility. The Chief Operating Officer of Regional Bank theorizes how customer analytics could drastically improve operations, marketing, and customer service; however, the small organization may not be fully ready for implementation. The following comments note how technology is playing a larger role in Regional Bank's operations:

"We have to work on efficiency. We are very interested in data mining and business analytics. That is the way the industry is going, finding out more about our customers and finding better ways to meet needs. It would allow us to better understand consumer behavior, though. We could better predict what a consumer wants right before he/she need it or wants it. We would be able to get the next best product in the hands of the customer faster. To do that, we have to use the knowledge we gain from the customer and understand when exactly to approach the customers."

The Chief Executive Officer of the regional Trust Company reinforces this theme by stating:

"There is no growth without going more electronic. You have to have the technology to process more and more trades. Now we are all electronic with our trades and execution."

The Chief Financial Officer of Startup Bank states:

"We focus on the mobile technology and the convenience and cost savings. When more and more customers want a convenience service provider, we will be the top choice and will be able to adapt a little faster than others."

The direct correlation between technology and efficiency is readily apparent, as also observed by the Chief Financial Officer of Regional Bank, who discusses how the bank uses technological advantages in the industry as a whole to improve efficiency and save time and money:

"We don't have a vault here. That is a big part that technology plays. Our vault is networked into our system so we always know how much currency is at a branch. When a customer withdraws cash, the machine simply spits out the cash, so it makes it much easier and efficient on our front-line workers. The information from that withdraw is then sent to the internal system automatically, so no one out front has to get to a vault in any of our branches. It saves a lot of time and people."

The Chief Executive Officer of Regional Bank summarizes with the following:

"Innovation is about making operations more efficient, cost savings, and technology."

The desire to solve inefficiencies throughout the organization is obviously at the forefront of many executives' and managers' minds. According to a previous study by Berger, Hancock and Humphrey, inefficiencies in U.S. banking are quite large, and the industry appears to lose about half of its potential variable profits to inefficiency (Pennings & Harianto, Diffusion of technological innovation); however, this statistic is improving given better execution and increased experience of financial services firms. These researchers

found that technology plays a key role in the performance of banks, especially since large banks spend approximately 20% of non-interest expense on information technology, and this investment shows no signs of abating (Pennings & Harianto, Diffusion of technological innovation). As the industry changes, technology becomes more accessible, and financial products become more commoditized. Consequently, managers in these firms have to compensate through solving inefficiencies throughout entire organizations.

Financial Services Firms' External Inputs

As eluded to in the previous section with the discussion on the integration of technology and internal operations, most, if not all, innovations in these firms were sparked by the external environment. As many of the innovations and changes discussed in the previous section solve issues of inefficiency, the sources and ideas for those changes come from outside the institution. An institution observes other firms implementing a process or introducing a new product, and the institution is prompted to do the same. According to a previous research study, most retail banks do not have internal research and development functions, and if they do, these groups play an important but ultimately a small role in the overall innovation practices of the organizations. Marketing, business units, information technology, and a complex web of external information technology suppliers, consultants and competitors drive the innovation processes in banking. That particular research study continues to state that a bank, translating this pressure to innovate into actual technological and organizational changes, is dependent on the presence of external consultants and of suppliers of technology such as vendors (Pennings & Harianto, Diffusion of technological innovation).

The importance of strong external connections and the dependence on external ideas, innovations, products, and systems is further supported in this research study. Most, if not all, of the projects and changes in these small, financial services firms are the direct result of some sort of communication and network outside of the firm where ideas are collected. Each of the interview participants mentioned a connection to other firms, the interaction between competitors, and the influence technology and new products has on the market. The topic of external idea input was discussed by the Chief Executive Officer of Regional Bank, who noted that even though implementing paperless meetings saved costs and labor, he could not attribute the idea to internal creativity. He states:

“The idea for electronic meetings was an external idea since many of our board members serve on several other boards where that was implemented.”

The Chief Financial Officer, who solved issues of inefficiency by using technology to develop an electronic vault system throughout the entire organization, notes:

“I’m not sure when the idea for this rolled out, but it was an external idea. We knew we needed to do it mostly because other banks were using electronic vaults. We have to keep ahead and leverage the technology.”

As many of these banks cut costs by implementing faster, more efficient processes, others use technology to reach more customers and provide additional conveniences. This has typically resulted in the emergence of online financial services websites where a customer can open deposits, transfer funds, management accounts, etc. from his or her home computer. Yet again, this was not an original concept for small institutions, which have watched larger, more experienced institutions struggle with having an online presence for years.

These smaller institutions have reached the point where the external environment will require an online presence, customers will demand it, and the technology is executable. The Chief Operating Officer of Regional Bank discusses a new online presence which has been adopted from other organizations:

“Right now we don’t have a presence online. We want to change that, especially since other banking institutions are working on it. We have to be cutting edge and offer the best, most convenient products.”

These institutions are clearly observing others and implementing similar, if not identical, projects into their own systems. Interestingly, a trust company functions in the same way; the firm collects information from the environment in order to continue to provide the best products and services. The following firm did not have internal research and development but instead used the product innovations of other firms in order to continue providing the best products. The Chief Executive Officer of Trust Company explains:

“We have to have the same products as a Vanguard or Fidelity even if our clients don’t use them. We have to also be able to provide an obscure product, even if that doesn’t serve a client’s need, because clients like to know they have options and that we are big enough to handle many products just like our competitors.”

According to another researcher, consumers are demanding anytime-anywhere delivery of financial services along with an increased variety in deposit and investment products. Investment companies continue to reinvent different types of funds for different uses, demographics, and risk tolerances, leaving smaller firms no option but to replicate the products. Choice of demand deposit accounts with a desired fee structure, the advent of new investment vehicles such as index funds, etc. all fuel the banking customer’s desire for new and better financial products (Pennings & Harianto, Diffusion of technological innovation). Even if the previous executive or the organization has no direct tie to competitors, the firm continues to monitor new products in the market in order to become a fast follower. The Chief Executive Officer of Trust Company goes on to explain how a product or service in financial services can be a hot trend with clients and becomes a necessary addition to the firm’s product offerings:

“You just have to know how to talk about different plans that we offer just like our competitors, even if it is essentially the same thing. But we have to stay on top of what is vogue in the investment community by providing the same products.”

The trend is also very clear with credit unions. Credit unions, as discussed by the following Vice President, are extremely cooperative, especially in this case where credit unions attend credit risk forums, regularly communicate on rates, and even share branches. The Vice President discusses how the communication and cooperation among credit unions has helped implement a new online website:

“Well, credit unions are very cooperative. We share a lot of ideas with other credit unions, and a lot of them have implemented new online systems recently. We also called a lot of other credit unions in order to get their opinions on finding a vendor and moving the project forward. Other credit unions helped a lot by recommending different vendors, especially since there are only a limited number of core providers. We then had to just assemble our internal team to manage the project.”

A pertinent question to ask at this point is how these organizations network with others or keep up with changes in the industry. The Chief Operating Officer of Startup Bank, a growing bank, discusses how his firm keeps up with industry movements primarily through publications and general networking. He explains:

“We keep up through a lot of publications. We get about 15-20 emails a week from publications and different sources just about what is happening in the industry. We can see what other banks are doing, see if they are growing or acquiring another bank, etc.”

The Chief Financial Officer of Regional Bank explains a similar monitoring technique:

“It is easy to follow the rates of other institutions. We have a service we subscribe to that allows us to check other banks’ rates. We usually check it on a weekly basis at the least. Through this service we can check up on other banks’ information as well. We know what we pay, we know when other banks are opening offices and branches, we know what others’ rates are, and we need to know quickly.”

The Chief Operating Officer of Startup Bank goes on to explain how the network of bankers, the friendships and ties to other organizations, help instead of hinder the banks’ innovative processes:

“As far as keeping up with the industry, we have a big peer relationship network. We have a lot of friends in the industry who work at other organizations. We have constant communication with them. We also have user groups so we can learn from customers and learn from other organizations outside the industry.”

This banking institution is somewhat unique in that the firm is relatively new and organized through the efforts of existing bankers in the community. It is not surprising that these individuals still have strong ties with other bankers in the area. However, the trend is clear among financial services firms and their sources of innovation. The external environment, the decisions of competitors, and the products developed by larger organizations, are the main source of innovative ideas for smaller, community institutions. As competitive as the industry main seem, the level of cooperation among competitors is surprising to say the least. These institutions, as mentioned with credit unions, rely on each other to produce innovative solutions to problems. The Chief Financial Officer of Regional Bank summarizes the need to monitor and adapt to external factors wonderfully:

“A successful bank needs to be sort of an outsider, an observer, a collector of industry information, who watches other parties and understands the external forces.”

This study reinforces others studies on firm innovativeness. One scholar, who focuses on the skills, characteristics, and experiences of firms in regard to their innovativeness, notes that a bank’s stock of skills and experiences does not have to be internal. These skills evolve from external sources, and in fact, an organization can further leverage its ability to use knowledge and innovation by using external sources of information and developing its own internal knowledge (Pennings & Harianto, Technological networking). According to another researcher, innovation requires a complex network of interpersonal and intergroup relationships, is an intensely social endeavor, and is a process involving very informal connections between internal and external employees and consultants (Dougherty & Bowman, 1995).

Top managers must recognize, publicly acknowledge, and support the entrepreneurial network by retaining, and perhaps strengthening, these informal or formal networks external and internal to the firm. Building connections such as these may not directly enable radical innovations, but they do facilitate more incremental innovations, which represent the vast majority of innovative activity. However, building these connections may also release energy and attention for the breakthrough innovations as well (Dougherty & Bowman, 1995).

Financial services firms provide a good setting to understand how external technologies from other industries and other institutions can become merged with its own. Its firms show sharp variations in technological innovation, and networking among banks, as well as between banks and vendors of information technology, is widespread. While technical innovations, including new smart cards, electronic functions, online deposit making, and mobile technologies are comparatively simple, their widespread diffusion among all banks is essential for them to yield efficiency improvements. As a firm accumulates networking skills, it increases the probability of innovation and the greater the firm's ability to innovate by leveraging the skills of others (Pennings & Harianto, Technological networking). These companies have leveraged the skills and knowledge of others in order to improve operations and services, and they have also found a way to fit these innovations into their overall service and growth strategies.

Financial Services Firms' Balance of Local Service, Growth and Leadership

The most prevalent theme on the minds of financial firms' managers and executives is that of balancing the focus on customer service with the desire to grow the business. As firms use technology, have a need for improved efficiency, and use their external network of industry professionals, the organizations are also struggling with the balance between capturing the next big idea and continuing to satisfy customers in a personal way. In a highly competitive market with many larger competitors, these smaller institutions have to both leverage the technology through new products and processes and also strive to provide the best customer service in a very traditional way. Each of the interviewees spoke about this critical balance and mentioned the subject approximately twenty times throughout the interviews.

The Chief Executive Officer of Regional Bank explains what the management team is thinking in regards to the company's dual strategy in mobile technology and customer service:

"In our small communities people really want to get to know their bankers. So we are very focused on serving customers. But, we also need to stay on top of technology and look more into it. It's an important balance between our tech focus and our customer service focus especially as we move into new markets."

The Chief Financial Officer of the same Regional Bank discusses how different functions within the bank, the lending side and the deposit side, focus on different levels of technological improvements and traditional customer service:

"Deposits are becoming very commoditized, you don't even have to have physical locations anymore. But when small business owners need a loan, we want to give them excellent customer service. You have to have that local lending aspect that is driven by excellent technology and the customer service aspect on the other side."

The same banker also notes how important this overall balance can be:

“A lot of change and innovation comes from the way we distribute our products, develop our technology, and our marketing efforts, while still staying a people business.”

The need to “stay a people business” is apparent in these smaller firms. The Chief Executive Officer at Trust Company explains how having the right products and the right technology is just the first step. The company has to add exceptional customer service to the mix. The executive states:

“We often ask ourselves if we should have an awesome online site or use lots of numbers. But, to make a sale we have to have the stuff that much larger competitors have, even if it doesn’t get used, just to start the discussion with a client. We have the same products and then add on superior customer service and show our customers that their money is safe and we understand their goals.”

The Chief Executive Officer goes on to explain:

“We are focused on people first. We keep a hold of our core strength, even as we grow to use more electronic processes and grow into new markets. We want our customers to say ‘it was nice to get someone to help.’ Once we get customers in the door with our product offerings, we want to give them a much better customer service experience than our competitors.”

The balance of new innovations and traditional business varies across organizations, though. In the more modern bank, which has more information technology infrastructure and fewer branches, the balance tends to err on the side of more technology and new products. As the previous organizations strive to obtain more customers through improved customer service, this institution is more focused on customer convenience via innovative technology. The Chief Development Officer of Startup Bank explains:

“We decided to be less heavy on brick and mortar locations and to focus on online banking and mobile services. We wanted to be able to grow when the time came, so that sort of planning had to start when we were organizing the bank. We didn’t want to be stalled when we started growing, like other banks are now.”

The same institution still struggles with communicating value to customers. When asked how Startup Bank strives for both technology improvement and customer satisfaction, the Chief Operating Officer responds:

“It’s a huge challenge. When we have a bigger market and we continue to grow, we face the challenge of not communicating or touching our customer. You have to have some sort of connection and brand recognition with the customer, even if you are focusing on technology. But as we grow, we know that we will need a lot more relationship bankers and a lot of middle managers. Those people drive that personal connection that people need from a banker.”

Another reason this balance may tend to favor new technologies is that the younger generation, the next generation of strong deposits, does not need the same personal attention

and customer service as that of the older generations. The Chief Development Officer of Startup Bank explains how the Internet may actually be a great way to communicate more effectively with customers:

“It can be interesting because we want the younger generation to become more involved in banking. The internet is a great place to start that. Since depositors really don’t make a habit of coming into the branching, those are the people we need to target. We have to get young, tech-savvy, depositors to use the online banking site.”

A great goal for a bank is to pioneer new services techniques that strengthen relationships with customers while also achieving a high degree of efficiency through operations and technology (Thomke, 2003). As organizations delve into this complex and often conflicting balance, the need for strong leadership and direction emerges. A subtle, yet still emerging, theme from this research has been the need for strong, visionary leadership which defines this intricate balance between technology, the need for efficiency, communications with the external environment, and the need for superior customer service. Most, though certainly not all, of the innovations discussed have been a product of visionary leadership. There are, of course, exceptions to this rule; however, over half of the innovation thought process occurs at the executive level. The Chief Executive Officer of Regional Bank states:

“The CEO is the key driver of innovation. They have to be. I have to be that driver that continues improving.”

The Chief Operating Officer of Regional Bank explains:

“It is important here that we set a tone from the top, do more for less, and then give people personal responsibility for their projects and departments. We don’t always check in with each other.”

The Chief Operating Officer of Regional Bank takes on a slightly more direct role in guiding and implementing new initiatives; however, the direction from the top of the organization is still very clear. She explains her dual role as idea generator and implementer:

“As COO, my role is to brainstorm ideas and implement projects. We are really big on idea generation, and that comes from the executive team. A lot of my role is implementing those projects, making sure the right people are working on a project, and also generating some of the ideas.”

The following Chief Development Officer of Startup Bank explains:

“Our executives are really involved with the changes that are going on. They can answer a lot of questions about what is new and how we incorporate new ideas. Since we are a start-up bank, we are really innovative.”

Several approaches to innovation strategy-making are possible, as one researcher notes. The “logically incremental” approach, for example, begins with a broad direction set by senior managers, who focuses innovators’ efforts into certain domains. This is clearly the case

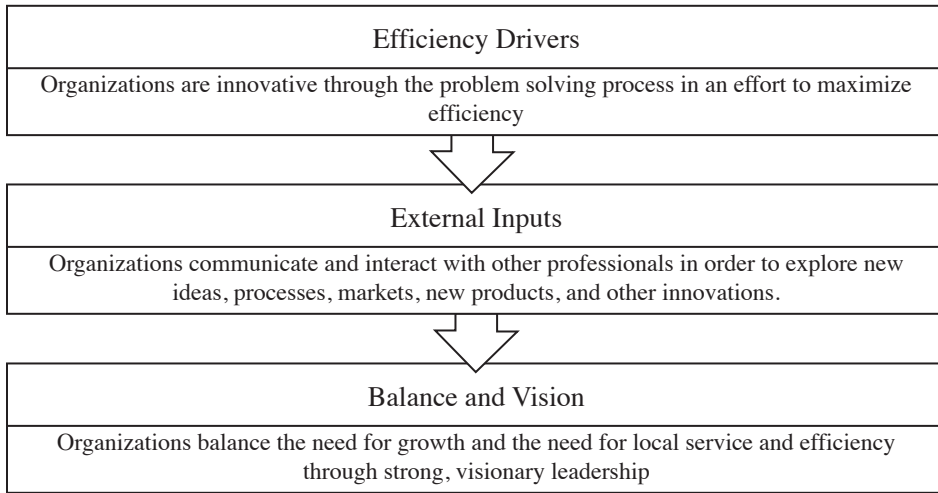
in many situations within these firms, especially as visionary leaders find the balance between growth prospects and short-term needs, allocating resources accordingly (Dougherty & Bowman, 1995). However, as pervasive as this seems, there are still a handful of firms who uncover and implement many of their changes from the lower levels. Even in these smaller firms, many ideas, especially those centered on the need for more efficiency, originated from middle managers or people in lower positions. Thus, the role leaders play in determining firm performance is still under debate. Some view leaders as products of their environments with little power to control structural and systemic factors that determine organizational actions. Others view leaders as powerful decision-makers who consciously choose among diverse sources of action, and so determine the fates of their firms. An intermediate position views leaders as bridging the external environment and their organization, thereby facilitating adaptation to the environment (Bantel & Jackson, 1989). This study concludes that the third option is true. Leaders in these organizations network outside the firm, recognize inefficient processes, understand how technology can better operations and customer satisfaction, and balance these innovations with the core customer service needed in financial services. The bridge between long-term and short-term goals and the strategic decision making process is certainly in the hands of upper management.

Conclusion and Discussion

This research leads to some conclusions on the sources of innovation in these smaller, financial services firms. First, these firms are innovative in the sense that they improve processes, increase operational efficiencies, and learn to process large amounts of information as their organizations grow. The first source of innovation in these firms is the need for improved efficiency. In other words, these organizations are solving problems of inefficiency through novel, innovative solutions that allow them to stay competitive in the market. Secondly, these firms rely on their external environment for new, novel ideas for products, markets, operations, technology and other new changes. This second source of innovation can involve close-knit networks of professionals, the close monitoring of competitors, regular review of banking publications, or the use of software in order to monitor other institutions. These institutions heavily rely on external innovation sources for these novel ideas, especially in the ultra competitive market. Thirdly, these firms balance the need for long-term growth and the need for customer service and short-term efficiency needs through strong, visionary leadership. Leaders in these organizations understand how to grow the business long-term and also understand how to empower employees to solve inefficiency issues and provide excellent customer service in the short-term.

This study has produced a rough model of innovation sources that can be used by financial service firms to better understand how to better explore and exploit new ideas. Leaders have to support the drive for better, faster, more accurate operations; they have to interact and communicate effectively with external sources in order to gain industry knowledge; and they must provide the vision behind the organization's long-term goals of growing and entering new markets. The following model shows some of the key findings of the study, based solely on interviews of industry professionals. The model simply shows the main sources of innovation in these firms, however. Each a financial services firm may have other, possibly even more innovative, sources available.

Innovation Sources For Financial Services Firms



This project concludes by detailing some of the major sources and inspirations for financial services innovation, and the literature on innovation sources and ambidexterity in firms supports some of these broad conclusions. According to the literature, successful firms innovate by exploring new products, services, and competences, and exploiting existing ones, balancing these two initiatives, just as this project has come to conclude. March, the researcher on ambidexterity and balance within firms, argues that “exploration includes things captured by terms such as search, variation, risk taking, experimentation, discovery, and innovation. Exploitation includes such things as refinement, choice, production, efficiency, selection, implementation, and execution.” Exploration has been assumed to be a long-term focused activity, while exploitation typically involves shorter periods of time. Organizations should pursue both exploitative and exploratory innovation simultaneously (Marabelli, Frigerio & Rajola, 2012).

According to researchers and observers, there are three main processes for innovation in retail banking. The first process, which tends to be mostly exploitative, involves high formalization of policies and focuses on cost savings and the pursuit of efficiency. The second process, which tends to be exploratory, involves low levels of centralization and formalization which enables greater autonomy and flexibility. Finally, the third process incorporates characteristics of both models: it has a degree of autonomy in terms of decision-making; at the same time, it focuses on cost savings and rationalization of resources (Marabelli, Frigerio & Rajola, 2012). The third process, involving both exploration for long-term strategy and exploitation of short-term, innovation solutions to problems of inefficiency, is strongly supported by this research. These institutions exhibited a strong degree of ambidexterity, balancing long-term and short-term goals, working through technology and the need for local service, and understanding how to exploit and explore existing external innovations.

Other studies confirm that ambidexterity in banking can lead to exceptional profitability. One suggests that the impact of exploratory and exploitative innovation on a unit's financial performance is moderated by environmental aspects, and if managers understand how to leverage external knowledge, the firm can become quite profitable (Pennings & Harianto, Diffusion of technological innovation). Contrary to the study's

hypothesis, pursuing exploratory innovations in a competitive environment does not harm short-term profitability, as long as firms understand the importance of continuing to exploit existing technologies and make processes more efficient (Jansen, Van Den Bosch & Volberda, 2006). According to March, “The basic problem confronting an organization is to engage in sufficient exploitation to ensure its current viability and, at the same time, devote enough energy to exploration to ensure its future viability” (O’Reilly III & Tushman, 2011).

Ambidexterity requires senior managers to accomplish two critical tasks. First, they must be able to accurately sense changes in their competitive environment, including potential shifts in technology, competition, customers, and regulations. Second, they must be able to seize them by reconfiguring both tangible and intangible assets to meet new challenges. According to O’Reilly III and Tushman, the actions, behaviors, and design choices made by the senior leader comprise the dynamic capabilities that enable firms to simultaneously explore and exploit and emphasize the key role of strategic leadership in adapting, integrating, and reconfiguring organizational skills and resources to match changing environments (2011).

Throughout this project, themes have emerged that hopefully shed light on some of the issues facing managers and executives in financial services in regards to innovation. Management in these firms can take some advice by understanding that efficiency-driven problem solving, the external environment, and strategic management are key sources of financial services innovation and improvement. Managers and executives have to be able to recognize inefficiencies throughout the firm with the help of middle and lower level managers. The most effective managers and executives also interact with others in the industry, learn from publications, use consultants and vendors and resources, and seek out the information needed to execute a project. These managers also understand the key balance between short-term efficiency and exploitation of resources and the long-term strategic goals of exploring new ideas, products, markets, and customers. Further research is needed, however, especially within each of these themes mentioned. Research within larger firms or within smaller firms in a different service industry would greatly enhance our understanding of the innovation phenomenon.

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