Financial Markets **INSIGHTS**

Bridging the Gap:
New Approaches to Creating a Culture of Innovation

In the last four years, investment banks have been significantly underspending on innovation. According to data compiled by the Boston Consulting Group (BCG)[1], change-the-bank (CTB) spend is almost flat at a rate of around one percent and only a small proportion of that spend is on true innovation, with as much as 80% focused on legacy system upgrades.

At the same time, demand for cutting-edge technologies and agile systems has never been greater, with financial organisations increasingly recognising the need for innovation to become an ingrained part of their corporate culture. The FinTech industry is also no longer in its nascency, but many firms still struggle to ensure their solutions are suitable for adoption at an institutional level.

In this article, Nicola Tavendale and Mike O'Hara of The Realization Group speak to ***Kim Johannessen*** *of TreoTrade, Seismic Foundry's* ***Cathy Lyall, Richard Balarkas*** *of Squarebook, Nomura's* ***Simon Hornibrook, James Maxfield*** *of Ascendant Strategy and Lloyds Banking Group's* ***Sophie Bialaszewski*** *and* ***Kate Simmons,*** *about what can be done differently by both financial institutions and FinTechs to put innovation back at the heart of the industry.*

Introduction

Financial services are only just emerging from a decade-long period of stagnation, which has contributed in large part to the low levels of FinTech investment we see today, says **Kim Johannessen**, co-founder, TreoTrade. "The problem is that people are stuck with legacy technology and technical debt," he adds. "It's been a very tough time for financial markets post-2008 and people haven't been looking to invest massively." As a result, the larger institutions have spent a lot of time downsizing in order to survive, with technology investment spends only tending to focus on 'RegTech' solutions.

"In the meantime, the rest of the world has moved on," Johannessen explains. The new generation of university graduates are taking their technology skill sets to the likes of Google, Facebook or Amazon, instead of straight to an investment bank, he adds. "This has fuelled even more stagnation in the industry, which now has a relatively ageing workforce – who are all working with old technologies." A boom in venture capital firms is, however, enabling a new breed of FinTech firms to spring up, often using similar technologies to the Silicon Valley giants. "The main reason why banks should be adopting these new technology stacks is so they can attract a younger workforce," warns Johannessen. "By sticking with their legacy platforms, they are making it very difficult to attract new talent to come and work for them on outdated technology."

[1] Boston Consulting Group: "Fintech in Capital Markets 2018: Boosting Productivity Through Technology Innovation"

The only way to move that forward is to work on a platform which is like-for-like to where the talent is going at the moment. However, according to Johannessen, banks generally tend to have difficulty transitioning to new ways of working, either because they are afraid of change or are risk adverse.

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Cathy Lyall, co-founder of Seismic Foundry agrees. “Large organisations have a real problem with creating a culture of innovation because there are too many vested interests, so you really need a strong push from the top,” she explains. “Therefore, it is difficult for many banks to take a consistent approach to innovation across the organisation.”

As such, the Heads of Innovation need to have a clear remit as to whether they are trying to achieve group-wide change, by attempting to get all parts of the organisation to buy into innovation, or they are aligned to given departments and their respective budgets. “A group wide approach is actually a much broader remit of culture change,” adds Lyall. Therefore, most organisations still approach this on a department by department basis, often with varying levels of budget allocated to innovation projects, rather than applied across the board. Lyall warns that this approach has resulted in instances where innovation ends up being a “bad word” at a cultural level, creating resentment among the wider workforce and other departments rather than being viewed as something positive.

Internal challenges

On the other side of the equation, FinTechs are still seen by some organisations as being “one-trick ponies” who focus on just one specific operational aspect. “The only way that innovation produces results, at the moment at least, is where it is applied for specific solutions with respect to a given issue, whereby innovation is held to a given return on investment rather than a cultural mind-set change,” Lyall explains. “Innovation heads don’t have a free rein, but have to look at the return on investment (ROI), which is a good thing, but is difficult to apply on a group wide basis.”

But the banking industry also recognises there is a need for change and is now actively embracing innovation. “We all agree that there is going to be a fundamental paradigm shift in the way we do things, in our operating models and the way we do change over the next few years – and it is going to be fundamentally driven by innovation,” says **Simon Hornibrook**, global head of client lifecycle management and operations innovation, Nomura. But the more salient point is that this does pose a massive challenge for financial institutions, he warns. Major banks have historically been a product of takeovers, organic growth and past infrastructure decisions, which has resulted in part with architectures that are highly complex, and disparate and with difficult to enhance legacy systems.

“The reality of this situation is that such systems do not lend themselves easily to innovative agile change, making it hard to embrace and push forward,” Hornibrook adds.

But a significant cultural blockage still exists in investment banking which is dictated by the structure of these firms, says **Richard Balarkas**, non-executive chairman, SquareBook and former President & CEO of Instinet Europe. This has resulted in many banks having completely separated revenue generation from the front office and back office functions.

Overcoming the hurdles

“In many banks you have a head of research, a head of trading, a head of a particular product area, whose carrot and stick is 100% dictated by revenue coming through the door,” Balarkas explains. “To a large extent, that individual, no matter how frustrated they are, has very little control over the costs that get allocated to their business line by all the shared service areas.”

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According to Balarkas, this has resulted in the individuals who are focused on competing and bringing revenue through the door often having very little control over all the infrastructure that they use to do that – particularly when it comes to straightforward procurement. “I think that separation of duties has always made it really quite difficult for banks to be fast and responsive,” he argues.

This creates a significant problem for FinTechs with smart, innovative ideas in that they find it almost impossible to know who they would need to talk to in these behemoth organisations. And even if they identify someone who can make that buying decision, that person may not be in their job in six months time, Balarkas explains.

But many organisations are also aware of the blocks that stand in the way of them ‘adopting’ innovation – starting with how such changes are perceived. “Even the term ‘adoption’ tends to imply that there’s a team internally pushing something or trying to change people, or that we’re introducing something external,” says **Kate Simmons**, head of innovation culture and FinTech collaboration, Lloyds Banking Group. “That term implies it is quite a passive thing.” Instead, the bank is working towards making innovation “everybody’s job”, in a bid to create an organisation full of innovators who are sensing and responding to what’s needed in this space.

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“Therefore ‘adoption’ almost becomes a nonsensical term, because it’s what everyone is living and breathing,” Simmons adds. “Many of the initiatives that we’ve looked at - and rolled out - within Lloyds have looked at not just changing behaviours, or mindsets, or ways of working, but to encourage individuals to champion a truly living, breathing approach to innovation in their own areas.” She explains that this in itself is a massive goal and one which can only be achieved by taking one step at a time and bringing people with you. “It may be a slower and messier approach, but the key thing is that it will be more sustainable,” Simmons argues.

Perception vs reality

Sophie Bialaszewski, head of innovation culture and events, Lloyds Banking Group, agrees, adding that there has also been a notable change in approach from the FinTech side as well. “Four or five years ago, many FinTech panel discussions focused on ‘compete or die’,” she explains. “But the reality is that just isn’t the case - and actually now we are seeing a lot more collaboration.”

There appears to be a genuine willingness to explore different avenues and to select one that is right for their organisation and, ultimately, the customer, Bialaszewski adds. “In financial services, we have a really good ecosystem,” she explains. “We have good conversations with the FCA, the FinTechs, the accelerator programmes – it’s a really collaborative environment.”

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In fact, the general negativity around banks, and leadership in banks, being “dinosaurs” who are scared of innovation is a common misconception, adds **James Maxfield**, managing director, Ascendant Strategy. And according to Maxfield, the world of protectionism, which is often cited as another reason holding back innovation, disappeared to a great extent around 10 or 15 years ago. “In general, the leadership in banks is typically quite innovation-hungry,” Maxfield says. They have normally gone through quite a lot of changes in their working lifetime, be that mergers, acquisitions, the 2008 crisis and all the other major events that have happened in this industry. “So in reality a lot of the leadership in this space is used to dealing with change, used to dealing with new products and is actually quite open to embracing innovation,” argues Maxfield.

There is also now a tipping point in the market’s awareness of the need for innovation, which creates opportunities, Johannessen adds. “We see this a lot, especially with many of the MiFID II solutions that were put in place. Cloud-hosted, new vendors came into this space to serve those looking for a lower cost, hosted solution and something that’s easier to integrate,” he says. “That is probably where the new FinTech world has an advantage.”

Need for standardisation

“Data is everything, and the modern world is moving to a place where you can access all your data from anywhere, from any platform,” Johannessen adds. Whether that be through AI or machine learning, that seems to be the new kind of approach to it. So, having a datacentric vision or a strategic platform is the way forward.” Many larger institutions have been focused on “firefighting” for the last five years as they prepare for MiFID II and have focused on implementing solutions to bridge any gaps while also trying to reduce costs and boost their P&L. And instead of spending two years implementing a solution on site, the new breed of FinTechs are able to leverage API’s and web services to do it in a fraction of the time.

“But it’s not something that can just happen, there is no miracle product out there that can just be installed and off you go,” Johannessen says. “The winners are the ones who have a well-designed roadmap to strategically move away from their legacy technology towards a more modern platform and approach.”

There is also a need for greater standardisation to help FinTechs deliver and deploy their products to organisations, starting with the ‘proof of concept’ stage. Although every institution will have specific requirements which they will need to ask about, the remaining 90% or so of their questions will be the same across the board – so FinTechs should be able to better streamline the process, Lyall explains.

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"FinTech firms can also help themselves by making sure their own product can be integrated easily via API linkage etc; and, although cloud services are the future, having a capability to deliver on premise for those institutions that don't want to share data in the cloud, is also important," Lyall adds. "In addition, it depends on the decision-making power your sponsor has. For example, the Head of Innovation may not have budget to implement projects, but is more of a conduit to the relevant teams, therefore it is important to clarify who is the budget owner for a Proof of Concept or ultimate engagement within the group."

Hornibrook agrees that standardisation is important, adding that his vision is to create a data orientated "digital backbone" with a clearly defined workflow that would facilitate a simplified environment, allowing new FinTech to be "plugged in" to the banks infrastructure. This would also enable the opportunistic replacement of such solutions if and when a more compelling offering came along. "Challenger banks have fundamentally based their flows on a "data first" philosophy and it is fundamental to driving their infrastructure. The rest of the industry needs to get there but there is a long way to go," he adds. "Again, this will require greater levels of industry standardisation – for API's, product taxonomies, data and market processes."

The industry has a patchy track record of collaborating on solutions to common problems, as seen with the changes to KYC and AML rulings, he suggests. "All institutions have similar regulatory obligations" Hornibrook explains. "In this space in particular it should be relatively easy to offer an industry service with a mutualised process and cost beneficial service. However fundamentally the problem is institutions have all interpreted the rules differently and whilst their policies are all in line with regulatory requirements the implementation of these policies are somewhat unique to each institution, making it difficult to provide a one size fits all solution." So competition in the FinTech industry can in itself be a challenge for banks looking to invest in innovation, with a glut of products which ultimately offer very similar types of solutions.

Simplify the process

"Picking winners is very difficult," Hornibrook says. "But if you can set up your organisation and your structure internally to take advantage of being able to quickly onboard emerging opportunities into your flows, then this will be key to success."

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On the FinTech side, Maxfield believes there are three key things which firms can be doing better to make this process easier and encourage institutions to invest in innovation. Firstly, firms need to have better empathy and understanding of the needs, and constraints, faced by banks, both in terms of their shareholder concerns and as highly regulated entities. "You really have to understand your customer and how their buying decisions are made," he explains.

Secondly, many FinTechs overlook the importance of their own credibility when it comes to executing a solution within a very large scale, complex institution. "If you are a five- or ten-man technology house, your ability to lead in the integration and the transformation in a tier-one bank is going to be quite difficult," Maxfield says. "A lot of big sell-side institutions don't have deep pools of internal change resource, so you need to know who can help you go in and implement that."

And finally, FinTech's need to consider what constitutes success when working with a big organisation, Maxfield adds. "If you are pitching a wide-scale transformation or replacement of a large amount of infrastructure real estate in an organisation, that's either going to entail a five- to ten-year programme, or you will have to do something very, very radical," he explains.

"Both will probably be above and beyond the risk appetite of most firms." Unfortunately, quite a lot of organisations have already tried this approach, according to Maxfield, but then had to halt the programme in only the second or third year - and have ended up wasting quite a lot of money as a result. "So FinTechs need to start thinking differently around how they package innovation and how they plan to deliver it into an organisation," Maxfield says. "You can plan strategically, but you have to implement tactically."

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James Maxfield, Ascendant Strategy

Moving forward

Industry initiatives such as the Financial Conduct Authority's regulatory sandbox also seek to foster innovation in the market and encourage firms to adopt FinTech solutions. However, this may also be simply another reflection of the fact that the industry as a whole tends to be slow to innovate, argues Balarkas. "If you don't get innovation, you don't get competition," he adds. "If you don't get competition, things go stale." According to Balarkas, the FCA is right to be trying to stimulate additional competition in this way because there are a number of oligopolies now developing in the financial services, which ultimately is not good for the health of the market – or the end users.

But in financial services there is also a genuine interest, even from the regulators, in fostering innovation, adds Bialaszewski. "It's all about how you can nurture the ecosystem that you're in, so that you can collectively make it better," she explains.

One of the ways Lloyds contributes to these efforts is by running a FinTech mentoring programme, which aims to bridge the gap in dialogue between FinTechs and the incumbent institutions. "The more we understand about each other, the easier it will be to collaborate and partner in the future," Bialaszewski explains. "We expect to see a maturity in some of the accelerator programmes as well." For example, a FinTech the group has been working with, Rainmaking Colab, changed their model this year around how they work with organisations. "There will continue to be collaborations, but they will be more mature based on what we've learnt over the last three years," Bialaszewski says.

Partnerships are a core part of the bank's innovation strategy, Simmons agrees, but adds that they need to continue focusing on how these collaborations can happen faster and more smoothly. Ultimately, this will lead to an emergence of radically different business models, with a richer ecosystem of organisations working together in a bid to solve this problem. "We're finding really creative ways to do that, both at the grassroots level but also at the strategy and leadership levels as well," she concludes. "There's an absolute understanding that this really is key to both sides of the equation - FinTechs and incuments - remaining relevant, now and in the years to come."

For more information on the companies mentioned in this article, visit:

www.treotrade.com
www.seismicfoundry.com
www.squarebook.co.uk
www.nomura.com
www.ascendant-strategy.com
www.lloydsbankinggroup.com

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