Publication: FA News (Financial And Advisory News)
Date: Sunday, October 01, 2017
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The art of managing INNOVATION RISK

Deciding not to innovate is a zero-sum game. A company either assumes the risk associated with innovation to gain a competitive advantage, or it must deal with the inherent threat of being leapfrogged by a competitor or start-up.

In today's highly competitive financial services sector, the greatest risk lies in the opportunity cost of not innovating.

Disrupt or become obsolete

Kodak, for example, was the first company to develop the digital camera. However, fearing it would cannibalise its film business, Kodak selected not to disrupt itself. That decision led to its demise, as the digitisation of photography was the inevitable end-point of a process that was already in play.

The asset management, banking and insurance sectors are in a similar process of innovation. Due to the current rate of innovation, if companies are not actively working to disrupt themselves, they will soon become obsolete.

Financial services providers need to find ways to manage innovation risk to remain relevant and competitive. This can prove tricky for larger enterprises with an entrenched corporate culture and legacy systems in place.

Implement new concepts

Many, therefore, create decentralised innovation hubs, while decision-making remains centralised within the organisation. Executives who manage the possibility that innovation will disrupt traditional business models often lack the courage to implement new concepts.

This intention-behaviour gap then gets exploited by start-ups. They are agile enough to scale an idea and disrupt industry verticals. It is also not uncommon for individuals who worked in these hubs to take a concept that was developed, but never adopted, and implement it themselves.

Much like digital photography, innovation and disruption in financial services is inevitable. The major consideration relates to a company's approach, particularly in a depressed economy when the margin for error is smaller and the risks amplified.

To be successful, companies need to be clear about both the outcomes and the implications – for the established business model and the company culture. A process to manage fundamental company change must be strategically implemented.

And while the need to innovate is clear, innovation for the sake of it will not deliver a return. Companies should first interrogate whether an idea will enable it to do things differently – and better – than competitors, and if it meets an intrinsic human need, or solves a problem. If it does not, then the risk of failure greatly increases.

Having established the business case, the usual next step is to identify technologies that can enable innovation. While this can increase the speed of development and deployment, decrease costs, and improve transparency, it is a fallacy that technology is a prerequisite for innovation. As such, large capex on solutions is not always a magic bullet for mitigating innovation risk.

A willingness to innovate

By ensuring innovation (be it process design or product development) businesses can align old structures with new differentiated offerings to broaden their markets. And, this will safeguard against innovation killing off an existing revenue stream.

From a methodology standpoint, lean and agile approaches ensure concepts can be developed, tested and updated quickly. This reduces the commercialisation horizon, which in turn mitigates risk. It also means resources are allocated efficiently – especially as projects that are unlikely to deliver can be identified early and ditched. Then, companies can shift focus to efforts that hold the most lucrative long term potential.

However, the decision to innovate has to be driven from the top. Executives need to develop a greater appetite for risk and the conviction to implement new concepts. With the right mindset and approach, risk can be managed. Innovation can also be targeted at a specific market segment, which means a business does not have to bet its entire future on it – much like Apple did with the iPod. However, a willingness to innovate is undoubtedly needed to deliver growth in the current market environment.

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