

Innovation in financial services: **A McKinsey Global Survey**



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Financial-services executives see innovation as important to the performance of their companies, according to a recent *McKinsey Quarterly* survey. They view product innovation as most important and expect a growing role for business model innovation.

A majority of executives say innovation is more challenging for financial-services firms than for other companies, mostly because of short-term financial pressure.

Executives rate their companies as no better than adequate at fostering innovation through practices such as using consumer insights to drive new ideas and dedicating people, processes, and funds to innovation.

Most executives expect their company's spending on innovation to increase in 2007.

Innovation in financial services: **A McKinsey Global Survey**

Financial-services executives say innovation is critical, but that few companies have embraced best practices.

Most executives in the financial-services industry see innovation as very important to the ability of their company to meet short- and long-term performance targets, according to the latest *McKinsey Quarterly* survey of global executives.¹ Overall, the survey findings suggest that innovation will be a major competitive battleground in the financial-services industry. Respondents, who represent public and private firms in retail banking, asset management, investment banking, insurance, and other financial services, consider product innovation to be very important and view business model innovation as growing in importance.

However, a majority of the executives we surveyed view innovation as more challenging for financial-services institutions than for companies in other sectors. What's more, many survey respondents say that their company has significant room to improve performance on a number of common best practices for fostering innovation, such as using consumer insights to drive new ideas and dedicating organizational structures and funds to innovation. More than half of the respondents report that their company has pockets of successful innovation, but the efforts are not developed and sustained throughout the company.

¹ *The McKinsey Quarterly* conducted the survey in January 2007 and received responses from 322 executives: 85 from the United States, 145 from Europe, and 92 from the rest of the world. Of the respondents, 112 held C-level positions.

The importance of innovation

Despite the problems respondents see in their company's innovation practices, only 20 percent consider them to be less effective than those of their peers and competitors. Fifty-two percent regard their firm as more innovative, and a further 28 percent see their company as being equally competitive.

Regarding the importance of innovation, 57 percent of respondents say innovation has been extremely or very important to the ability of their company to meet revenue targets over the past one to three years (Exhibit 1).² Notably, executives regard innovation as even more important to their competitors than to themselves. Sixty-five percent perceive that innovation has been extremely or very important to their leading competitors' ability to meet revenue targets over the same period.

Innovation is also important to a company's long-term success, respondents say. A significant majority—67 percent—consider their company's innovation-related initiatives and investments to be important for meeting long-term as well as short-term performance targets. (A further 24 percent view innovation as important only for long-term performance, and 5 percent as important only for short-term performance.)

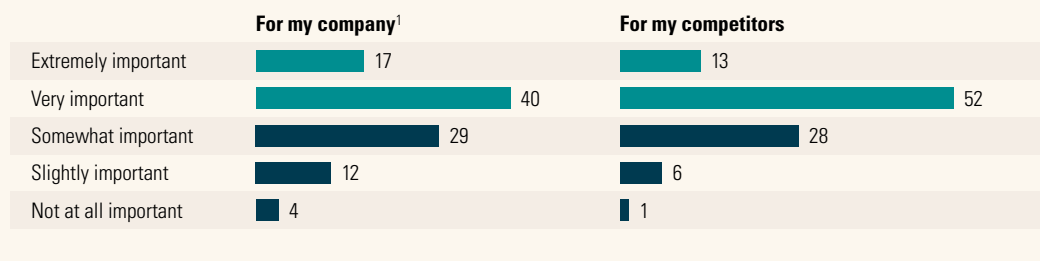
²The survey found a clear correlation between perceived importance and performance: more than seven out of ten respondents who rated innovation as extremely or very important to their company believed they are more innovative than their peers.

Exhibit 1

Competing on innovation

% of respondents, n = 322

How important have innovations been to meeting revenue targets over the past 1 to 3 years?



¹Figures do not sum to 100%, because of rounding.

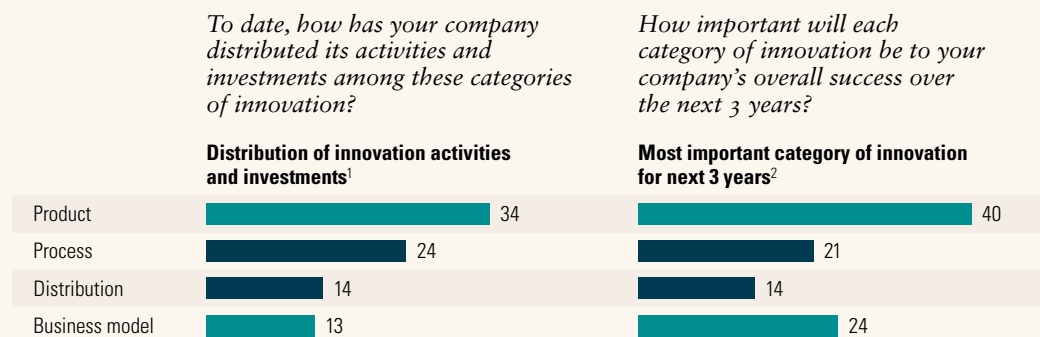
These beliefs may explain why respondents are bullish on the commitment of their company to spending money on innovation. Two out of three expect overall spending on innovation initiatives and investments to increase in 2007 compared with the previous year. Furthermore, fewer than a third say innovation spending is typically among the first areas their company targets when they cuts costs.

A gap emerges when the panel assesses the importance of the main categories of innovation to their company's success over the next three years compared with investments in these categories to date. Forty percent regard product innovation as the most important category for future success, but only 34 percent say it was the most important in past investments. The gap is even wider for business model innovation (Exhibit 2).

Exhibit 2

Making the right investments?

% of respondents, n = 322



¹Figures do not sum to 100%, because respondents who answered "don't know" or "equal investment" are not shown.

²Figures do not sum to 100%, because respondents who answered "don't know" are not shown.

The financial-services challenge

A slight majority of the panelists—54 percent—say innovation is more challenging for financial-services institutions than for companies in other sectors (Exhibit 3). Notably, US executives (at 62 percent) were more likely than their European peers (at 46 percent) to view innovation as particularly challenging for financial-services firms.

Those who see innovation as more challenging cite as the two most important reasons the cause and effect of short-term pressure: expectations of short-term financial success coupled

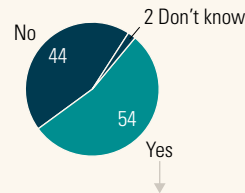
with resource allocation that slights innovation efforts in favor of short-term execution. Interestingly, respondents identify as the third most important factor a lack of organizational mechanisms that would encourage the generation of new ideas. Organizational shortcomings are a recurring theme in the second half of the survey, which explored how financial-services companies approach innovation and how executives view their performance in this field.

Exhibit 3

Why more challenging in financial services

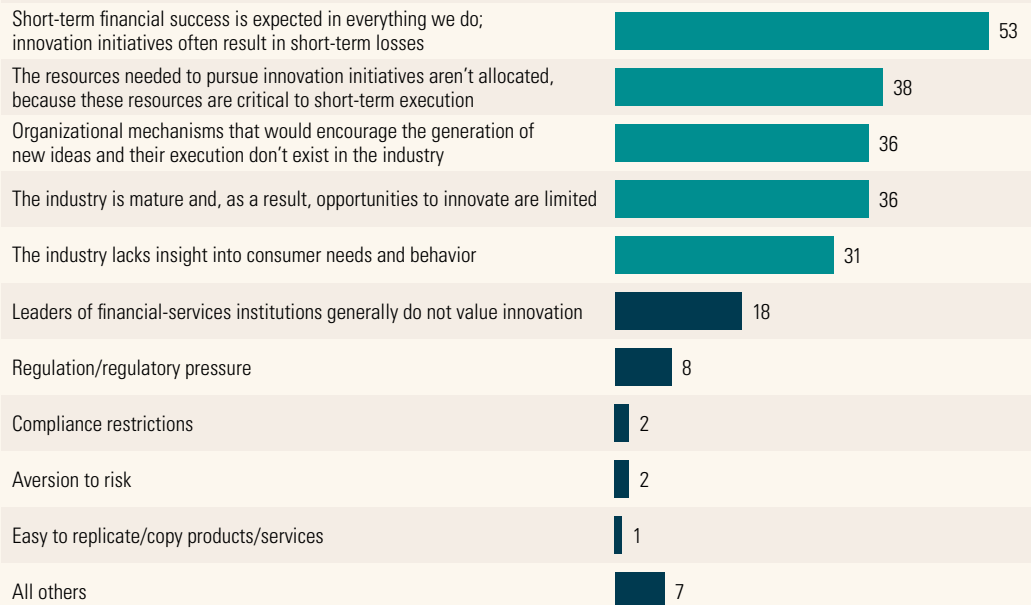
Do you think innovation is more challenging for financial-services institutions than for companies in other sectors?

% of respondents, n = 322



Which statements best describe why you believe innovation is particularly challenging for financial-services institutions?

% of respondents,¹ n = 174



¹ Respondents could select multiple answers.

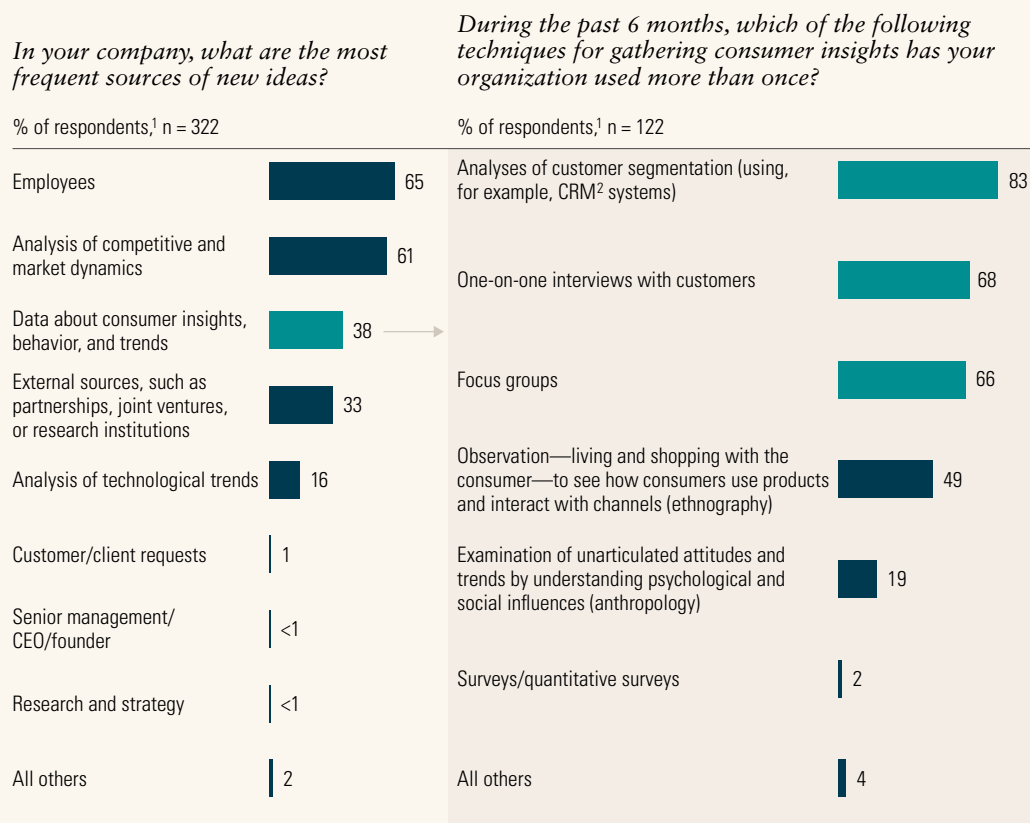
Sources of ideas

Several notable findings emerged when we asked executives to select the most frequent sources of new ideas in their company. Sixty-five percent identify employees, compared with less than 1 percent citing senior management, the CEO, or the founder of the firm. These answers could reflect a bottom-up approach to innovation at many companies, rather than active professional development and the management of an innovation strategy. The second most frequent source of ideas is the analysis of competitive and market dynamics, at 61 percent;

coming in a distant third, at 38 percent, is the use of data about consumer insights, behavior, and trends. External sources, such as partnerships and joint ventures, are in fourth place, selected by 33 percent (Exhibit 4). The relatively subdued roles of consumer insights and external sources suggest a fairly basic and conservative approach to innovation in large parts of the financial-services industry.

Exhibit 4

Seeking new ideas



¹ Respondents could select multiple answers.

² Customer-relationship management.

Organizing for innovation

As noted, in several areas executives indicate that their company has inadequate formal innovation structures. When asked to identify the barriers they face to commercializing innovations, 40 percent say the company lacks a formal process to line up the necessary internal resources (such as IT) and to prioritize projects for these support functions.

Even more striking, 40 percent indicate that the company lacks any organizational mechanism dedicated to facilitating innovation. Just over three out of ten say their company has an innovation council or committee that reviews initiatives and progress. And only one-fourth of respondents say their company has funds dedicated to innovation initiatives (Exhibit 5).

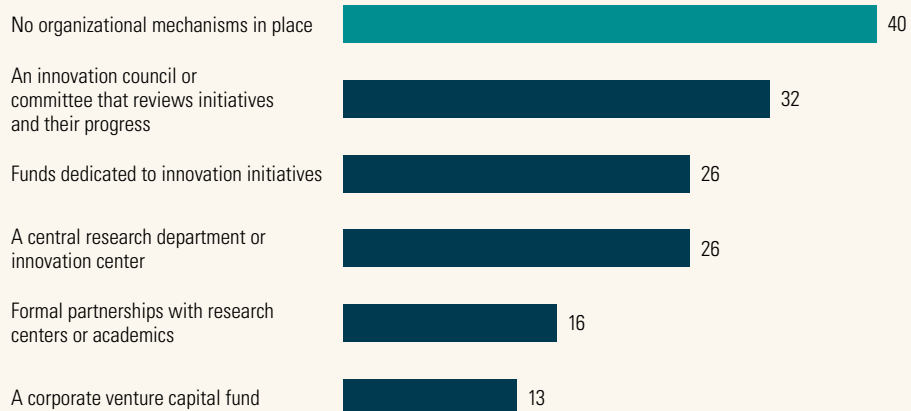
Executives whose company does have at least one such organizational mechanism in place say the ones that facilitate innovation most effectively are an innovation council, dedicated funds, and a centralized research department or other business unit responsible for innovation. However, even these mechanisms are seen as effective by only 30 to 35 percent of this group of respondents.

Exhibit 5

Getting organized

% of respondents,¹ n = 322

Which of these organizational mechanisms does your company currently have in place to facilitate innovation?



¹ Respondents could select multiple answers.

The performance gap

Most executives see substantial opportunity for their company to improve performance in practices that most industries regard as vital for successful innovation. Around 70 percent rate their performance as poor or merely adequate in the following categories: establishing clear incentives to innovate, setting clear targets and metrics for innovation initiatives, prototyping ideas for rapid commercialization, systematically providing funds for innovation projects, and developing a network of external partners (Exhibit 6).

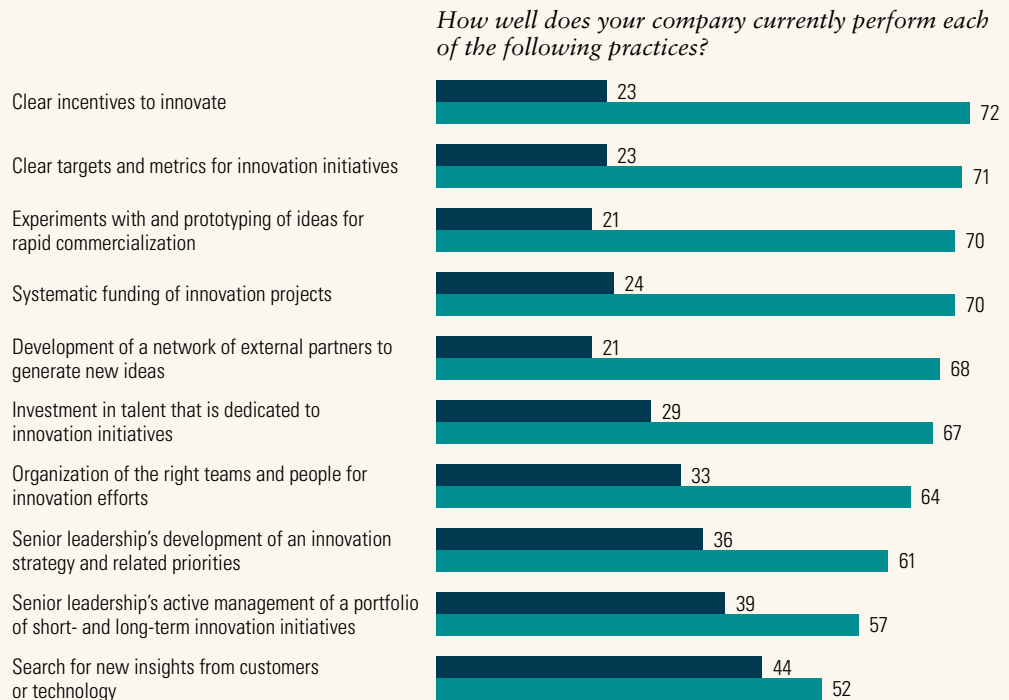
When asked which practices, if implemented effectively, would promote successful innovation, executives make people-related measures their top priorities: establishing clear incentives to innovate, followed by organizing the right teams and people for innovation efforts, investing in talent dedicated to innovation initiatives, and ensuring the senior leadership's active management of a portfolio of short- and long-term innovation initiatives.

Exhibit 6

More practice needed

% of respondents, n = 322¹

■ Well/extremely well
■ Poor/adequate



¹Figures do not sum to 100%, because respondents who answered "don't know" are not shown.



Contributors to the development and analysis of the survey include Marla Capozzi, a consultant in McKinsey's Boston office, Somesh Khanna, a principal in the New York office, and Zubin Taraporevala, a director.