PUZZLES CAN BE DIFFICULT

by Steve Brown

We don't know about you, but when the Rubik's Cube first came out in the 1980's, we tried for hours to get those little colored boxes to line up. We failed miserably, until we talked to other people and found there was a relatively easy way to defeat the game's complexity. As with games, complexity can find its way into banking and even some of the strongest institutions can become bogged down by management distraction, reduced profitability and increased risk as products are added. Don't get us wrong, we love to innovate, but there is also a fine line between being entrepreneurial and perhaps ending up with too much of a good thing.

The problem occurs in many organizations because it seems to make intuitive sense that one way to grow a business and increase profitability is by continually adding new products. Unfortunately, in so doing, companies also add more complexity to their product offering. Taken to an extreme, salespeople are overwhelmed and offerings mushroom, training suffers and customers begin to wonder what the organization represents. New products and services are difficult to launch and failure rates are stunningly high. What can bankers do then to help stack the deck in their favor and continue to innovate?

There is much more to launching a product than simply thinking it up, giving it wings and pushing it out to customers. Understand which customers might actually want to buy a new product long before it launches, how deep the target market is, soliciting unbiased customer feedback, ensuring a reasonable return on investment, calculating breakeven (based on as much real data as can be collected), using realistic adoption rates, managing marketing expenses throughout the product and support launch phases and ensuring adequate management time, buy-in and commitment will give new products the best opportunity for success.

Customer adoption rates are usually slower than predicted, marketing expenses are higher and the amount of time management needs to set aside to ensure each new product's success is significant. When you layer in training for sales staff, customer confusion and multiple product refinements that are usually required, things can get even crazier.

While all of these issues can arise when innovating, we believe bankers must do so to remain competitive over the long-term. The community banking business model is under fire from globalization, technology shifts and new competitors. Diligence is required and even strong banks must monitor the competition, innovate and reinvent themselves occasionally to retain their competitive position. In fact, studies show that banks that can find the right balance between complexity and innovation can reduce costs 35% and lift revenues as much as 40%.

Here are some things bankers can do right away to reduce complexity, increase opportunity and provide room for new product innovation:

- Review product offerings at least annually and calculate profitability. Ask whether each product on the list is doing what it should be, whether customers are still interested in buying it and whether it still adds value to the company. Does the product support the strategic vision, or is it a distraction? Jettison products that don't pass muster or sell them off to someone else.

- Set rules around innovation. For companies already straining at maximum sales capacity, only launch a new product when a less promising one has been dropped. This keeps sales teams focused and increases the likelihood of success.

- Closely monitor the financial data. New products may be sexy and cool, but financial prudence is also critical. Be sure to set minimum goals, understand breakeven timelines and get management buy-in on the cost structure needed to support each launch. Then, monitor results and report back.

- Don't get emotionally attached to any product. Many products fail, but that doesn't mean innovation isn't critical. Community bankers are in business to make money and profit is important, so innovate - but do it prudently.

To succeed, bankers must continually evaluate all product offerings, with an eye toward squeezing out complexity and redundancy. Results must be monitored closely and all processes should strive for continual improvement. Innovation is fantastic and banks should embrace it. However, innovation without structural support, customer feedback or any idea of how it will be sold is ripe for failure. Learn the tricks of the innovation puzzle and it will become easier to master over time.

BANK NEWS

Insurance Pressures

Bond insurance giants MBIA and AMBAC have close to an 80% chance of going bankrupt in the next 5Ys, according to credit default swap markets.

Foreclosures

A trade group reported that the number of new foreclosures in the US during Q3 was 60% higher than the number of borrowers that were able to receive home-loan modification and repayment plans.

FAS 157 Review

FOMC Chair Bernanke said calculating the value of complex assets has increased uncertainty in the market and strained the financial system. He suggested valuation rules be reevaluated to reduce investor uncertainty.