



Weekly Market Review

January 12 2015 — January 16, 2015

“Every space that you operate in has a potential for competitors to cross boundaries, leverage uncertainty that exists in every domain, and start to escalate and really push your agenda, because people power projects. Ultimately its human beings that are delivering these results. Its not schedules, its not business plans, its not strategic goals. Very often there is a vision behind it, but its people that push these agendas, and coming up with these solutions and people are wildly creative, widely innovative, and wildly unpredictable” - Mark Phillips—Professor of Project Management

Thinking in terms of Entrepreneurial Innovation

If you have never read Clayton Christanson’s classic business book “Innovators Dilemma” then do so. It’s a tale of the consistent missteps of firms over the decades to fail to understand shifts in their industry, to grasp new products and services, to advance onto the next S curve when the current path they are on has hit a horizontal asymptote. Here, I’d like to discuss innovation in banking, as I see it. To set the scene—innovation in this industry is slow and the culture is one of observer over action taker.

Whether we look at Silicon Valley as a whole, or a Facebook as a subset, disruptive technologies are the source of new innovative business solutions and are possible as a result of failure in industry leadership to recognize alternative opportunities in their space. Kodak had the entire camera film industry, but miscalculated the demand for digital technology, which eventually left them bankrupt. In banking, we need to have an eye on new technologies that will change the way people operate and interact with our services. The way that you beat competitors is with speed, responsiveness, and customization—not by imitating your neighbor and attempting to shave off a few bps in cost.

To be sure, you cannot be a leader and a follower. If you are to lead an organization, and lead that organization relative to its industry, you cannot wait for others to prove a concept. By that time its too late, the product begins to commoditize, and the market is well on its way to the next venture. Too often, organizations wait for a market to be large enough to be interesting. This more often than not fails as a management technique.

Instead, we should identify the powerful forces inherent in the human condition that can be the source of innovation. Peoples manifest priorities are the most important thing to understand, and then capitalize on. If we believe truly we are in the business of taking money (because a consumer hasn’t anything else to do with it) and giving money (because the consumer wants what they currently cannot afford in whole), then we are doomed to industry average NIM and ROE (or maybe not even). However, If we instead reshape these services, in a manner that attracts non-customers for reasons that have nothing to do with savings or borrowing, we may build out our own S-Curve and add value to our clients, as well as our owners. Disruptive technologies are not solutions to an existing problem of the firm but instead are causal solutions to a consumers problems, needs, wants, and desires.

An Example of Innovating in Modern Banking

A little known law (The American Savings Promotion Act: H.R. 3374 and S. 1597) was signed by the president into office on December 18th, 2014. This act repeals a long term ban on depository institutions using promotional raffles to acquire deposits. This is known in literature as Prize-Linked Savings Plan. Banks may now issue deposits (for our purposes stable retail deposits with literally no interest rate) that offer the opportunity to earn cash or product prizes commensurate with the amount saved. The U.S. gambling industry is an approximately 100 bil annual sales industry (35 bil casino revenues, 65 bil state lotteries). I believe that banks should begin offering a lottery based deposit product that awards the consumer the opportunity to win prizes. This can be an incredibly low cost way (without adding literally any interest rate sensitivity) to gain deposits and help promote savings rates amongst low income, under-educated, and young peoples. There is an insatiable desire to gamble and risk that the probability of winning doesn’t thwart. Innovation comes by taking something as mundane and even unsatisfactory as saving, and turning it into something fun, such as gambling (where of course the underlying amount invested is protected).

The current promotional rate banks pay is enormous and harmful to NIM. I believe this can be halved by a well thought out, well marketed campaign. Most banks have the people, the technology, the brand and the distribution system already in place. By taking advantage of new opportunities to encourage deposit savings through entertainment, banks may attract capital otherwise spent in state lotteries, casinos around the country, or just idle money sitting in other depository institutions.