Gradually, then suddenly

How obsoletion can move at glacial, and then suddenly, lightning speed

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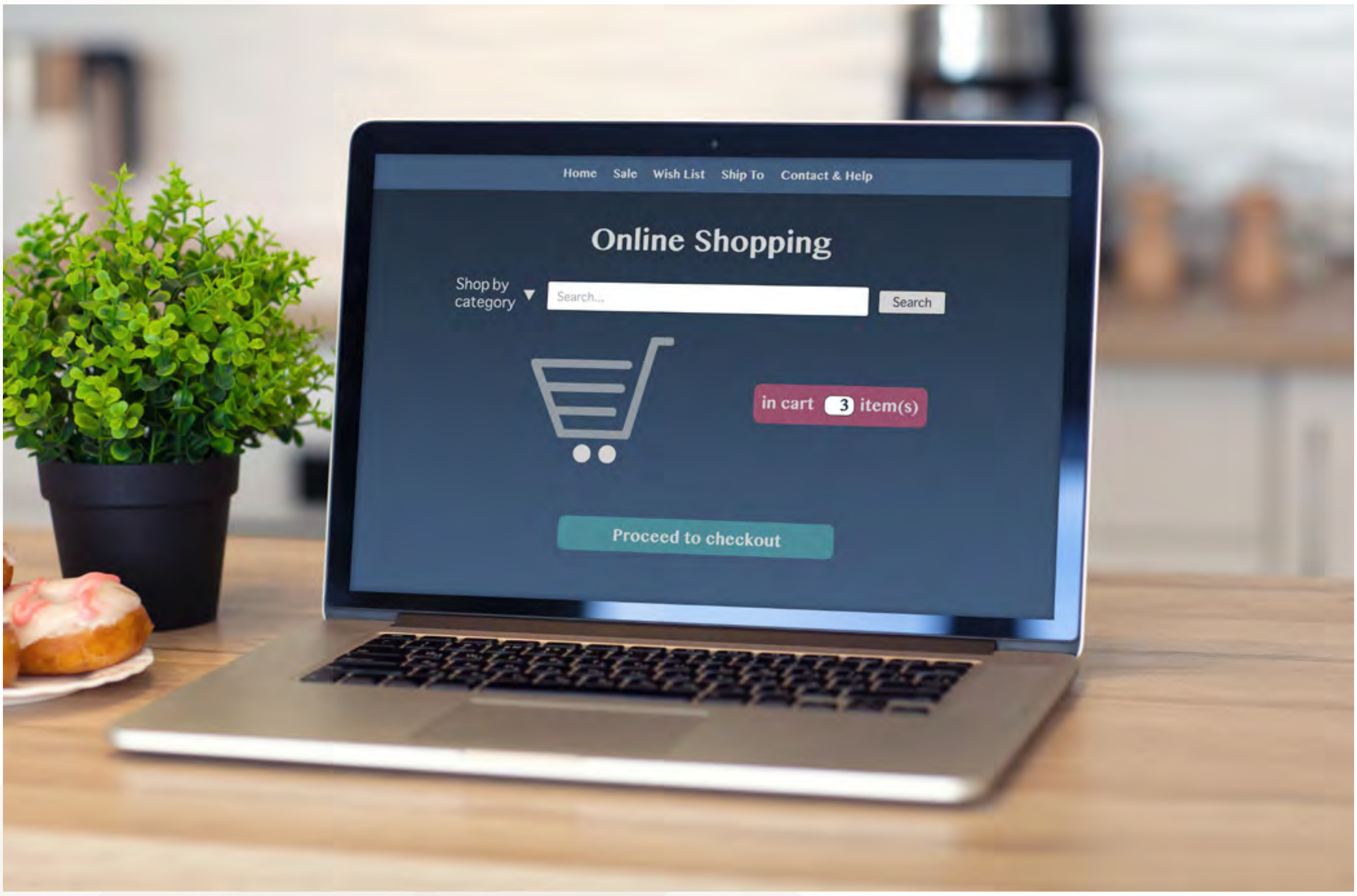
Introduction

This article considers obsoletion (the opposite of Futurism or investing in science & technology to safeguard the future) and how firms are responding to the threat of long-term decline from failing to change with their market and shifting consumer behaviours. Arguably, the last decade has seen B2C businesses facing a fundamental attack due to technological changes leading to new competition and driving swings in consumer behaviour. Add to that an extremely challenging political and economic environment and the Ernest Hemingway quote from his novel, The Sun Also Rises, springs to mind. When a character in the book is asked, “How did you go bankrupt?” he replied, “Two ways. Gradually, then suddenly!”. This applies equally to obsoletion!

The status quo has been changed in financial services and in a number of other sectors including music, film, media, automotive and retail (Debenhams, Top Shop, Evans Cycles, LateRooms are just a few of the many fatalities). Digital technology and smartphone usage have fundamentally altered how people interact with their service provider. Increasingly digital technology is not a differentiator, but it is instead a hygiene factor for most consumers who want to be able to self-educate and self-serve from their tablet or smartphone at a time convenient to them and without experiencing any wait time or delay. As progress unceasingly marches on, firms that increasingly depend on this ‘channel’ need to make frequent updates, refreshes and upgrades to a core competency. Yet many firms don’t have the right people, the right environment or the reserves to be able to do this and they will fall behind for periods.

There is a theory that the confluence of a number of factors (e.g. climate change, competition for food, prey evolving to become smaller to hide in crevices and undergrowth) led to the extinction of dinosaurs…only not all died out and instead some are believed to have evolved into birds. This might just be a useful metaphor for incumbent firms avoiding obsoletion.



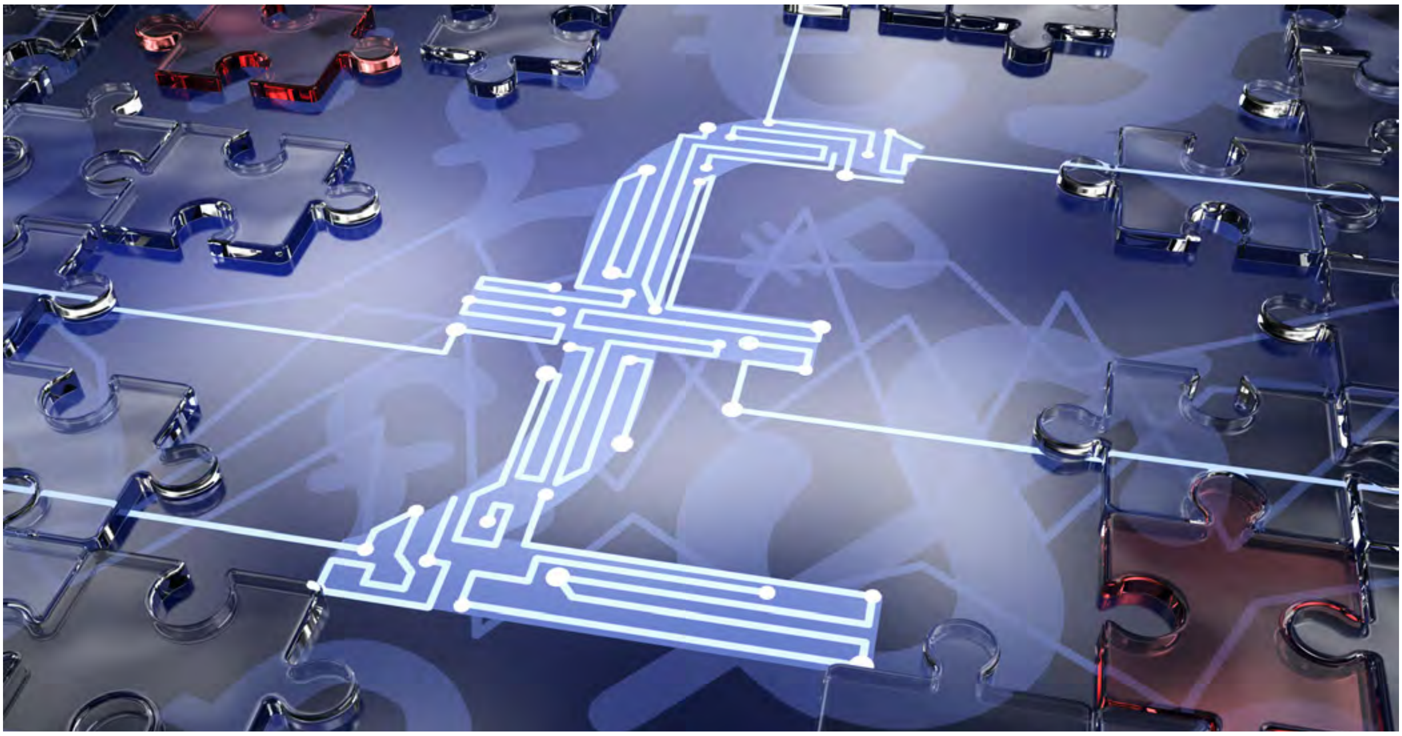
“Gradually, then suddenly” for financial services firms

The financial services sector’s confluence of factors that threaten obsoletion through a chipping away of profitability or attrition of customers includes gradual forces, such as:

- The reduction in physical footprint and the erosion of footfall.
- The low interest rate environment.
- Greater capital holdings required by the regulator, or indeed ever increasing regulatory demands in general.
- New digital banks simplifying and making the account opening process more customer friendly, especially in relation to completing ID checks and making payments.
- New one stop supermarkets that mean you can access all your needs via one platform but avoid putting all your eggs in one provider’s basket (e.g. Starling Bank’s customer friendly API platform).
- A steady decline in car ownership reducing demand for retail finance.

And factors that have the propensity to make more of a sudden impact such as:

- Severe brand damage from prolonged technology outages, financial crime attacks and severe regulatory fines for breaches e.g. ineffective anti money laundering processes.
- An economic slump that leads to greater debt persistency in unsecured lending books and, ultimately, increases debt write downs that could obliterate profits or create losses that erode capital.
- The disintermediation of the financial services ecosystem, as has happened with mobile phone payments and PayPal, could lurch forward again. Indeed, if the big tech firms like Apple and Amazon leverage their platforms, their loyal clientele and offer compelling services and products they would be significant competitors.



Survive and thrive - lessons from the past

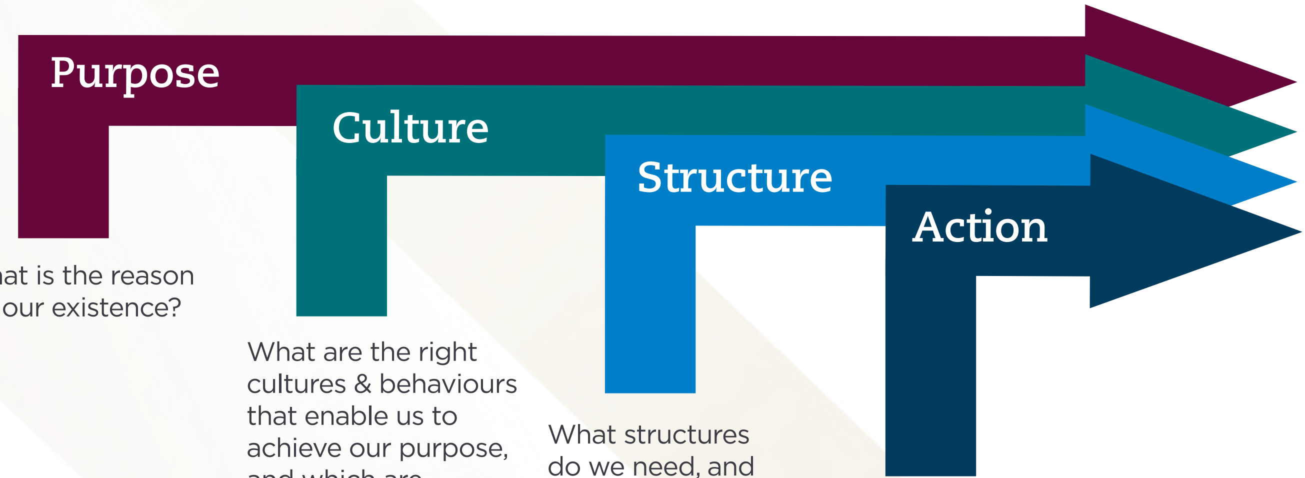
One company that recognised disruptive change and responded effectively was IBM. In their case, they saw that the information technology industry was rapidly becoming commoditised and shifted their portfolio to a more balanced mix of high-value offerings. This meant growing their service and software businesses, both through significant internal investments and through acquisitions, to help fill out their portfolio of products and services in strategic growth areas, such as analytics.

They also changed their operating model from one federated (by country or region) to a shared services model. Nine out of ten IBM employees now focus on developing, producing and delivering high-value solutions for clients rather than servicing the internal workings of IBM.

The swift and dramatic action taken by IBM's CEO transformed the organisation from the worst loss maker in a single year in US history ($5bn loss in 1992), to a firm which boasted a non-GAAP (non-Generally Accepted Accounting Principles) profit of $12.7bn in 2018. Of course, it is short sighted to judge a company's performance purely on profit, and IBM also illustrate this as in both 2019 and 2020 they continued to invest heavily to mitigate against obsoletion. In 2019, IBM completed the $34 billion acquisition of Red Hat, an open-source, enterprise software maker, to bolster their hybrid cloud division. In 2020, they invested in R&D and CAPEX, and announced the acquisition of seven companies focused on hybrid cloud and AI.

Protecting the future and successfully evolving means that organisations need to adapt to survive. We see IBM actively future proofing their business again with significant investments made in cloud and AI. IBM have also joined forces with EY to create a centre of excellence to help financial institutions adopt hybrid cloud solutions. This investment and partnership targets revenue in an area currently dominated by Amazon (AWS), Alphabet (Google Cloud) and Microsoft (Azure).

There are a number of sequential questions (and sub questions) to answer in order to develop and translate the most relevant strategy for your business. All of the answers will be unique and specific to your organisation and we suggest that you start with strategic purpose.



What is the reason for our existence?

What are the right cultures & behaviours that enable us to achieve our purpose, and which are detrimental?

What structures do we need, and which structures don't we need to fit our organisation's objectives and culture?

What actions do we need to take and in what priority order?

A. What is the reason for the organisation's existence?

In the IBM example above, their revised identity was very much around developing, producing and delivering high-value solutions for clients in order to turn around financial performance.

For your firm it might be:

- For investor return (dependent on the type of organisation and investor – private equity owned businesses typically look to maximise return and have a 3-7 years outlook whilst institutional investors investing pension funds will look for stable lower returns over a much longer term).
- To protect and reward members.
- To serve the communities in which they operate (e.g. credit unions).
- To serve a greater purpose (e.g. environmental or green finance).

The answer to this 'why do we exist' question will inform the strategic direction of the organisation. But no matter what the answer is, the need to be strategically aware is vital. There are many questions that need to be considered together so a successful viable future path can be set, monitored and adjusted as required:

- What is happening in the market?
- What are your competitors doing?
- What are your target customers needing or increasingly open to?
- What is the macro environment like and what are the emerging trends?
- What regulation are you facing now and in the future?

Answering these questions honestly and accurately requires objectivity, experience and a willingness to research, analyse and decide a relevant and proportionate path ahead. Yet whilst vital, the required objectivity, experience and skills are scarce!

B. What is the appropriate culture for the organisation?

Culture is often cited as the primary reason that strategic initiatives fail, and culture also sets the conditions for success.

Much is made at the moment of capturing the hearts and minds of Gen Y and of millennials and shifting the change methodology from waterfall to agile. Words like agile, non-bureaucratic, empowered, recognising and rewarding expertise are used to describe the target culture.

Often at this stage, organisations move swiftly onto step C and the desired culture is never embedded. Everyone has heard the analogy that ‘words are cheap’. Your employees and your customers need to understand and resonate with the words. Most importantly, they need the words and promises to be acted out, consistently and repeatedly. Whilst words and actions need to combine, they also need to be communicated regularly to reinforce the integrity of the cultural change.

The ongoing implementation of Environmental, Social and Governance (ESG) factors throughout the financial services industry demonstrates this integrity point well. Organisations will be well aware of the need for ESG as a prominent feature in their strategies however embedding a corresponding cultural change, often impacting profit, is also required. Without demonstrating this alignment of strategy and culture, they are unlikely to meet the demands of the regulator and of their customers.

In my experience, choosing a few symbolic things to be highly visible will demonstrate the authenticity of the new culture. I refer to this as the cultural totem pole and each of the faces on the pole should represent a significant element of the cultural change that you wish to embed. Every time your employee or customer makes eye contact with one of the faces then your new culture will be reinforced.

C. What structures are needed, and which structures are not, to fit the organisation's objectives and culture?

Structures can include organisation design, technology systems, processes, policy and governance. What we are looking for are the right structures that reinforce yet complement and that enable and support the desired results, culture and experience.

As well as looking for the positive traits of the new structures, it is always worth looking for the unintended negative consequences. For example, in looking to increase responsibility and ownership an unintended consequence might be internal competition for budget and resources, and an increase in internal politics.

D. What actions do I need to take and in what priority order?

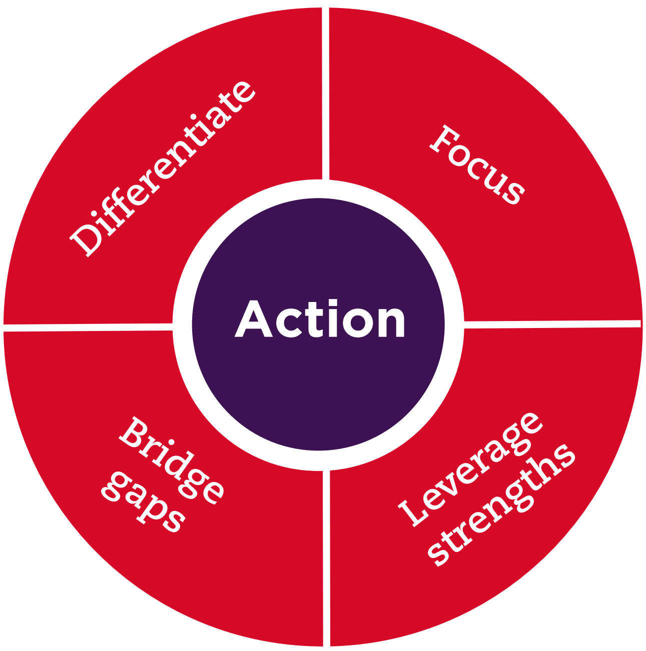
Focus - actions that demonstrate your selected strategy and culture and that reinforce these to your team and other stakeholders.

Differentiate - how will you measure the change and how will you know when you are delivering differentiated results and displaying the looked-for behaviours. What are the new Key Performance Indicators and how will you measure these?

Leverage strengths – determine your core competencies to leverage as strengths and prioritise how you use these to drive forward your strategy and deliver quantifiable and qualitative results.

Bridge gaps – what gaps exist in your current capabilities that will be essential to deliver your strategy and embed a new fit for purpose culture? What action will you take to develop or acquire?

Lastly but by no means least, communication - what action will you take to communicate progress along the journey, to celebrate successes and to take collective remedial action when required? Communication, preferably two way, demonstrates commitment to the journey as well as to the changes sought. A consistent theme of high performing businesses is that they prioritise communication with their customers and to engage their wider team. This tone and articulation of key messages should also be replicated through all channels, whether digital or physical.



Generic v. Bespoke Design

Never has it been more important for organisations to be open to look around them and take an objective view and determine what the factors are that are together influencing the organisation's present and the future. If nothing else do three things:

1. Stop looking over your shoulder at the traditional competitors and look instead at what your customers see.

2. Don't be tempted by a copycat strategy, even if elements seem attractive, as it is likely there are fundamental differences to what you can see that mean that organisation is unlikely to be direct comparison for your own.

3. By all means seek external experience, expertise and objectivity in designing and implementing your strategy however ensure that your data and unique strengths (and challenges) are factored into the exercise. Without this your strategy is unlikely to be a success even if executed brilliantly!

Get in touch

If you would like to discuss any aspect of developing your strategy or the translation of your strategy into an effective and results orientated change programme, then please get in touch.

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