Gradually, then suddenly

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

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Introduction

In my recent white paper, The Circle of Life, I explored the four forces of change that are impacting banking and the wider Financial Services sector and that should be considered when developing risk mitigation strategies:

1. Capitalisation

Insufficient reserves to deal with downturns or incidents within prescribed tolerances to avoid the taxpayer bailouts of the past.

2. Regulation

Increased regulation from several organisations domestically (Bank of England, Prudential Regulation Authority (PRA) and the Financial Conduct Authority (FCA)) and internationally as well as the fines and penalties they can levy to organisations that they deem as non-compliant.

3. Competition

Particularly from those embracing technology and new business models that appeal to consumers who are willing and eager to self-educate and self-serve online.

4. Obsoletion

The opposite of Futurism or investing in science & technology to safeguard your future, leading to long term decline that cannot be reversed.

Arguably, the last decade has seen the financial services sector facing the most fundamental attack that it has faced in over a century, 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 replies "Two ways. Gradually, then suddenly!"

This article looks in more detail at obsoletion. We begin by examining the key threats to financial services firms and finish by providing a strategic framework which can be used to avoid long-term decline.

Cataclysmic change

The status quo has fundamentally changed in financial services and in a number of other sectors including music, film, media, automotive and retail (Thomas Cook, House of Fraser, LateRooms are just a few of the many casualties). Digital technology and smartphone usage has fundamentally altered how people interact with, and what they expect from, 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 do simple things like pay bills, check their balance and track spending from their phone without experiencing any wait time or delay.

Updating, refreshing and upgrading technology has become a required core competence for many organisations looking to keep up with the unceasing march of technological progress. However, many of these firms do not have the right people, the right environment or the reserves to be able to keep up.

A recipe for disaster

Whilst digital technology is fundamentally altering how financial services firms engage with their customers, it is not the only potential driver of obsoletion.

There is a theory that the confluence of a number of factors led to the extinction of dinosaurs. Their departure was hastened by a combination of factors such as climate change, increased competition for food, prey evolving to better hide themselves from the ancient predator and the movement of tectonic plates changing the landscape. Yet, the birds we see in our skies are believed to be evolutionary ancestors of dinosaurs – they survived in a different form!

This might just be a useful metaphor for the drivers of obsoletion and the means of averting long-term decline – you have to evolve in order to survive.

“Gradually, then suddenly” for financial services firms

We have laid out below the confluence of factors that we believe threaten obsoletion both gradually, through a chipping away of profitability or attrition of customers and suddenly, through shock market changes.

Gradual forces

- The low interest rate environment;
- Greater capital reserves required by the regulator;
- New digital banks simplifying and making the account opening process customer friendly, especially in relation to completing ID checks and leveraging BACS functionality to remove delays in getting access to account credits (earlier access to their salary may encourage many customers to make their digital bank their primary account);
- 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.

Sudden forces

- An economic slump that leads to greater debt persistency in unsecured lending books and, ultimately, increases bad debt impairment that could obliterate profits;
- The disintermediation of the financial services ecosystem as has happened with mobile phone payments and PayPal could lurch forward again. Indeed, the launch of Apple’s titanium credit card that leverages their Apple Pay platform, their loyal Apple clientele and offers best in market conditions could prove extremely attractive to the market.

Survive and thrive - lessons from the past

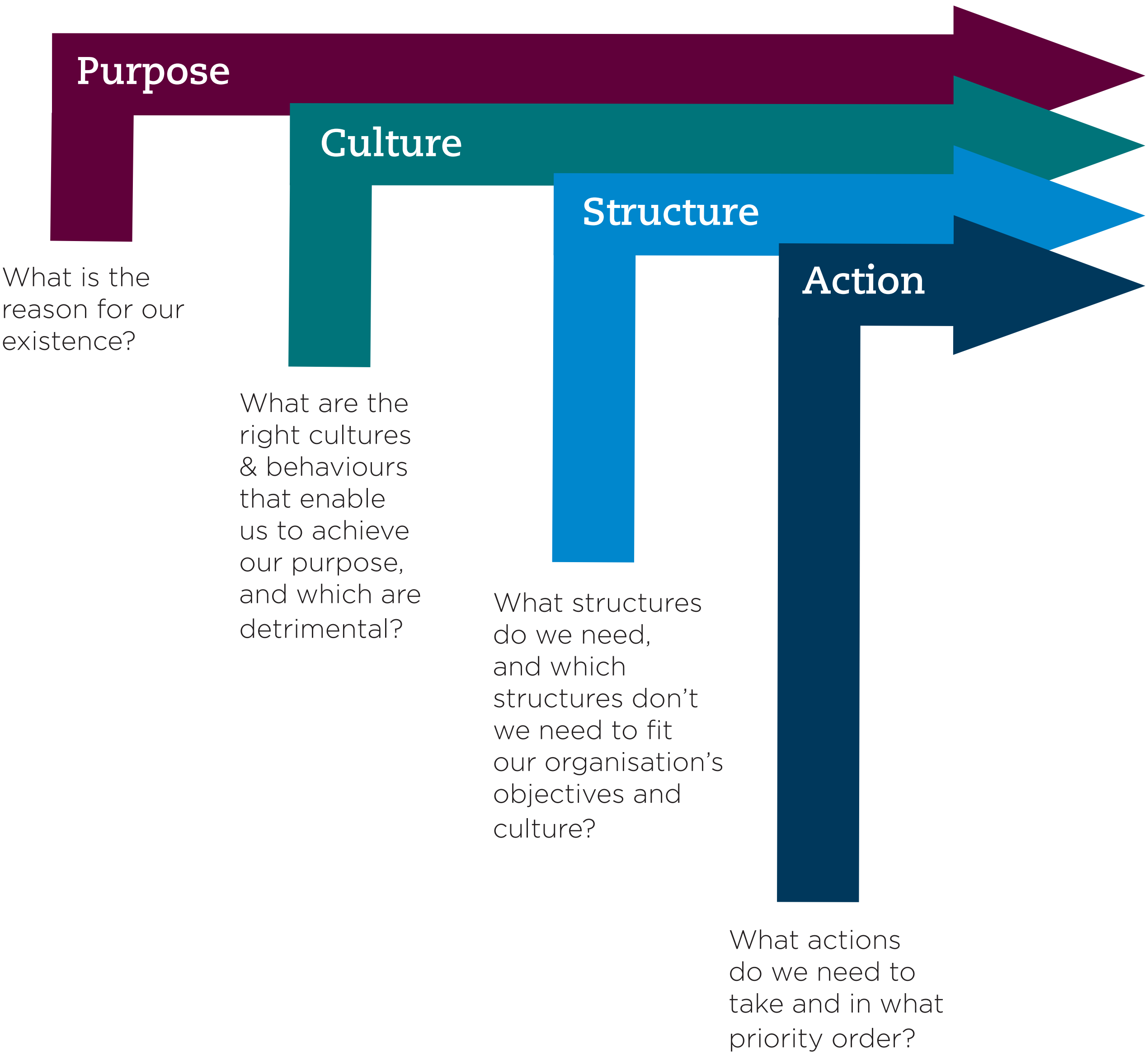
One company that recognised disruptive change and responded effectively was IBM. In their case, they saw that the information technology industry was rapidly becoming commoditised and shifted their portfolio to a more balanced mix of high-value offerings. This meant growing their service and software businesses, both through significant internal investments and through acquisitions. Indeed, they acquired more than 200 companies at a cost of $30bn to help fill out their portfolio of products and services in strategic growth areas, such as analytics.

They also changed their operating model from a federated model (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.

Avoiding obsoletion - Johnston Carmichael's obsoletion survival question set

In order to protect future profitability and revenue streams, firms need to adapt to survive. At Johnston Carmichael, we have developed a series of sequential questions that we believe firms should ask themselves in order to avoid the threat of obsoletion. These questions cover four key areas of a firm's operation:



Purpose: What is the reason for our organisation's existence?

In the IBM example, 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 year 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).

Guiding Principles

But the purpose alone is too broad a concept – it is often not tangible enough for those looking to initiate organisational change or the employees looking for inspiration and direction. Firms must, therefore, also articulate the Guiding Principles that they will operate under in order to achieve their defined purpose. For a building society whose purpose is to reward members, this could include providing products which consistently maintain member return at a particular level.

When setting Guiding Principles, firms must first take account of their own individual circumstances and their competitive environment – they should consider:

- What is happening in the market?
- What are competitors doing?
- What are the target customers' requirements and what are they 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?

Example

Deteriorating results gave IBM their wake up call and finally answering these questions gave them the route to turning around their business. Likewise, your ability to be objective and to simultaneously have the appropriate experience and the expertise to analyse, digest and decide a relevant and proportionate path ahead are becoming more important to your business. Yet, be under no illusion, the requisite experience and skills are scarce resources!

Culture: What is the right culture that enables us to achieve our purpose?

Culture is often cited as the primary reason that strategic initiatives fail, but if you get it right it can also set the conditions for success.

It has become fashionable to focus a lot of attention on capturing the hearts and minds of Gen Y and of Millennials and shifting the change methodology from waterfall to agile. Words such as 'agile', 'non-bureaucratic', 'empowered' and 'employee recognition' are used to describe the target culture. Often at this stage, organisations move on too swiftly and the desired culture is never embedded – it is left as a series of visionary soundbites rather than tangible behaviours.

Words are cheap

Everyone has heard the phrase 'words are cheap'. In the case of effective cultural development, your employees and customers need to be aware of, understand and resonate with your chosen culture. Most importantly, they need the words and promises to be acted out, consistently and repeatedly.

My experience is that 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, where 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.

Example

General Electric implemented a successful culture shift by abandoning its formal annual reviews in favour of immediate performance feedback. Regular in-person and online feedback – an important method of offering individualised, manager-to-employee mentorship, is proven to foster a more dynamic culture and increased employee retention by timeously reinforcing positives and constructively dealing with 'development' areas.

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

Structures can include organisation design, systems, processes, policies and governance. What we are looking for are the right structures that both reinforce and support the desired results, culture and experience.

Example

By the early 2000s, Google was a phenomenal success. However, in the following decade, it's meteoric success and expansion resulted in an increasingly complex entity to manage with intertwining goals, teams, funds, and managers. In 2015, Google's co-founder, Larry Page, broke up Google into its constituent parts, making each its own company all under the ownership of a new umbrella corporation called Alphabet. Each of Alphabet's companies has its own goals and a CEO focused solely on those goals. The structural reorganisation has proven to be a success with each company responsible for its own expenditures and income, meaning that they also enjoy a new sense of accountability and ownership.

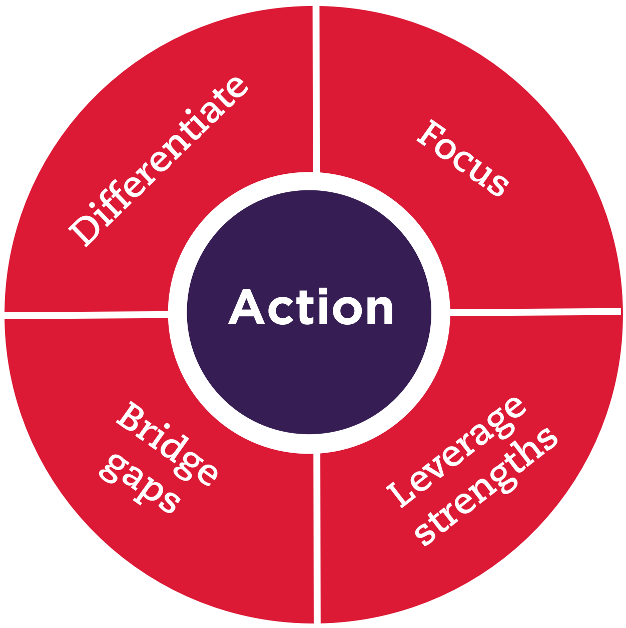
As well as looking for the positive traits of the new structures it is always worth considering the unintended negative consequences. For example, in looking to increase responsibility and ownership an unintended consequence might be internal competition for budget and resources and an increase in internal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

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

Your purpose, culture and structures are your design blueprints for your future organisation – they are your aspirational future state to combat the threat of obsoletion. However, they need to be turned into action – otherwise they are likely to become dusty blueprints on an obsolete shelf. There are four broad categories of action:

Differentiate – determine which game changing initiatives will deliver your strategy. Measure the change to ensure you are delivering differentiated results and displaying the desired behaviours.

Focus – before you can effectively begin your strategic change, you need to pick your priorities and at the same time stop doing certain things – you don't have unlimited resources after all. The Focus stage concentrates on determining your priorities and removing unnecessary projects and operations which do not align to your purpose, culture and structure.



Bridge gaps – decide which gaps you need to bridge within your existing capability set in order to deliver your future strategy. Seek investment where required.

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.

Lastly, but by no means least, communicate, communicate, communicate! Regularly communicate progress along the journey, celebrate successes and advise of remedial action when required.

Communication (preferably two way) demonstrates commitment to the journey as well as to the changes sought. For example, Monzo have placed communication at the heart of their purpose of solving customers' problems and their tone is very much about working together. They have also sought to articulate that tone on their website and explain how they will communicate in writing.

Become a bird, not a dinosaur

Never has it been more important for organisations to review the confluence of factors which may lead to their obsoletion and to take action to avoid long-term decline. If you do nothing else after reading this article, do three things:

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

2. Don't be tempted by a copycat strategy, even if elements seem attractive. It is highly likely that there are fundamental differences between your role model and your own organisation and consequently the danger that you are not comparing like for like. Blindly following a competitor with a flashy strategy could also lead to obsoletion – your capital is, after all, finite!

3. By all means seek external experience, expertise and objectivity to help you develop a tailored strategy, and execute it brilliantly!

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

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