INNOVATION READINESS INDEX™

MARCH 2019

The PYMNTS **Innovation Readiness Index™**, in partnership with payments and commerce solutions provider i2c Inc., gauges where banks are on the road to becoming innovators. We surveyed executives at more than 200 FIs in the U.S. (excluding the largest 25 banks) and scored the institutions from zero to 100 in terms of innovation readiness. The banks in our sample fell into four size groups: Those with assets below $500 million, $500 million to $1 billion, $1 billion to $25 billion and more than $25 billion. We divided the banks into three groups: Top, Middle and Bottom performers. We then analyzed the data to understand what, exactly, Top Performers are doing so well, and the lessons everyone else can learn from them.

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This Innovation Readiness Index™ was done in collaboration with i2c, and PYMNTS is grateful for the company's support and insight. PYMNTS.com retains full editorial control over the findings presented, as well as the methodology and data analysis.

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EXECUTIVE SUMMARY

True innovative success is not a one-time deal. Many one-hit wonders manage to create names for themselves with one great idea, but the best innovators know how to make lightning strike twice — or more.

This is difficult to do. Like lightning, the process involved in designing and producing a great product requires a very specific set of requirements. Not all of the elements are easily replicated, but businesses must learn to produce them if they want to gain and maintain a competitive edge.

This is especially true in the financial sector, which is overflowing with ambitious startups and technological disruptors. It is crucial that financial institutions (FIs) in this cutthroat environment understand what their customers want from new products and services, and that they deliver such offerings at lightning speed. They otherwise risk losing their customers to competitors.

This market pressure has produced something of a craze in the past few years, making the term "innovation" hard to escape. PYMNTS first teamed up with i2c in 2017 to measure U.S.-based FIs' innovative successes and learn exactly what it means to be an innovation leader.

We achieved this by creating a quantifiable measure: the Innovation Readiness Index™, scored on a scale of zero to 100. The higher the score, the more capable an FI is of designing, implementing and executing innovation plans. The highest-scoring FIs were categorized as Top Performers, while those that scored in the middle and lower ranges were classified as Middle and Bottom performers, respectively.

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We recently completed our 2019 assessment to see how intense 2018 financial market competition has affected the course of innovation over time.

In some ways, the innovation craze has simmered down since 2017 — at least among the financial ecosystem's most prolific and successful innovators. Our sample's average index score decreased from 37.8 to 35.3, and that decline was even more pronounced among our innovation superstars. Top Performers' average fell 16.1 percent, from 66.0 points in 2017 to 55.4 in 2018.

The best in the class were falling behind, and we needed to determine why that was happening. What had changed in 2018, and how was that slowing Top Performers' innovation initiatives? More importantly, what could they do to improve their strategies going forward?

For the 2019 Innovation Readiness Index™, PYMNTS once again collaborated with i2c to conduct an extensive survey of more than 200 decision-makers from U.S. commercial banks, local banks and credit unions — including those with fewer than $100 million in assets up to FIs with more than $100 billion — to learn how they had designed, created and released new financial products and features in the past year. It also asked about areas in which they planned to invest going forward.

According to our research, it took FIs longer to bring new features to market in 2018 than it had just one year earlier — especially among the sector's leading innovators. Top Performers moved fast in 2017, with 86.7 percent of them rolling innovations out ahead of schedule. Just 26.7 percent managed to do the same in 2018, a 62.9 percent year-over-year (YoY) decline in the share able to roll out their innovations early.

Inflexible core payments systems were partially to blame for this time lag. Approximately 49.2 percent of respondents said their IT infrastructures were inflexible, hindering their innovation processes throughout the past year. This is understandable: Consumers' technological demands of their FIs have changed rapidly during the past few years, but corresponding IT infrastructures have changed far less. In fact, many were still operating on the same legacy systems they had for decades.

It was also not that FIs wanted to avoid investing in new innovations. The portion of top-performing FIs that devoted

KEY TAKEAWAYS
2018'S FINANCIAL INNOVATIONS AT A GLANCE:

Top-performing financial sector innovators saw their innovations stall.

- 26.7 percent of FIs completed their innovations early in 2018.
  - This is a decrease from 2017, when 86.7 percent of Top Performers did the same.
  - In other words, there was a 69.2 percent YoY decline in the portion of Top Performers that were able to roll out new innovations early.
- 45.5 percent intentionally delayed releasing new products, preferring to wait and see the market trends that emerged before committing to innovations.
- 49.2 percent said their IT infrastructures were inflexible, hindering innovation initiatives.

FIs of all sizes struggled to identify lucrative investment areas.

- Most focused on innovation in consumer and corporate credit products.
  - More than 90 percent invested or plan to invest in the next years in new consumer credit solutions.
  - More than 85 percent invested or plan to invest in the next years in new corporate credit products.
- FIs focus on these areas because they are more confident in such innovations' ROI.

FinTechs are on the rise and unafraid to invest.

- Amazon, Kabbage and Square are just a few such firms homing in on FIs' bread-and-butter areas by offering SMBs innovative credit products.
- Many FIs do not seem to realize that they are competing with FinTechs.
  - Just 6.5 percent said they considered FinTechs to be their competitors.

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more funding to innovations than other budgetary items changed very little between 2017 and 2018, dropping from 86.7 percent to 80.0 percent. This decrease was not enough to explain their innovative performance declines. The reason FIs were slowing down appeared to have more to do with their own strategic choices than funding.

When asked, most said they intentionally held back on committing to and releasing innovative projects too early to avoid spending their money and time on products that would not generate sufficient returns on investment (ROI). Approximately 13 percent of FIs reported waiting until consumers had adopted a new technology before releasing their own similar products to the market, for example. Another 45.5 percent said they were fast followers of market trends, waiting to see what the trends were before quickly releasing their own products to fit them. In other words, some FIs were dragging their feet on innovation because they wanted to avoid the risk of releasing products that would not produce adequate ROI.

This makes sense in theory, giving FIs more time and market knowledge to apply to their innovation processes. However, it can complicate matters in practice. Most that are playing it safe have already lost market share by the time they react to emerging trends. This gives fast-moving FinTechs and challenger banks opportunities to move in and capture the customers to whom they would otherwise not have access.

Moreover, many FIs were focused on innovating the same types of products, especially credit offerings, meaning many of the solutions being released were remarkably similar. This put pressure on innovators to quickly release their products — before the market was saturated — or ensure that their offerings could outperform their competitors'.

These forces may have contributed to making mid-sized FIs the most successful innovators, however. Mid-sized firms must compete against both the small, innovative startups and larger FIs benefiting from economies of scale, after all. The intense competition created by this environment appears to have driven small FIs' index scores upward, though, as the highest average index score (38.3) went to firms with between $1 billion and $5 billion in assets.

That said, mid-sized firms were not radically more innovative than the rest. When respondents were grouped by size, the highest index score was just 6.8 points higher than the lowest. Rather than attributing any firm's success to its size, it was more accurate to say that FIs of different sizes enjoyed varying competitive advantages in the wider market. Any one of them might have been able to leverage those advantages to improve innovative ability, but whether it was able to do so was another matter.

The following pages will delve deep into the innovation practices of FIs throughout the country to outline what the most successful did in 2018, and what their actions can teach about the right and wrong ways to innovate.

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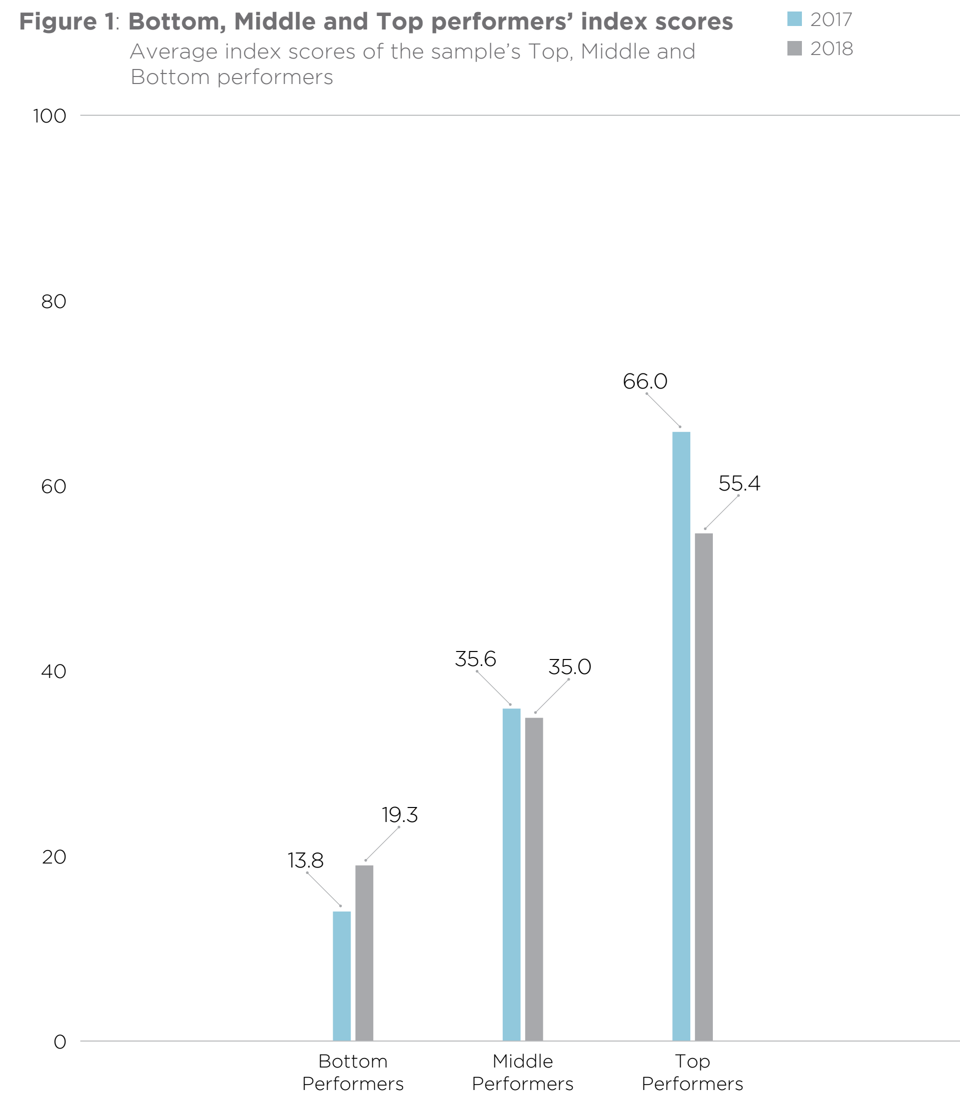
THE GOOD, THE BAD AND EVERYTHING
IN BETWEEN

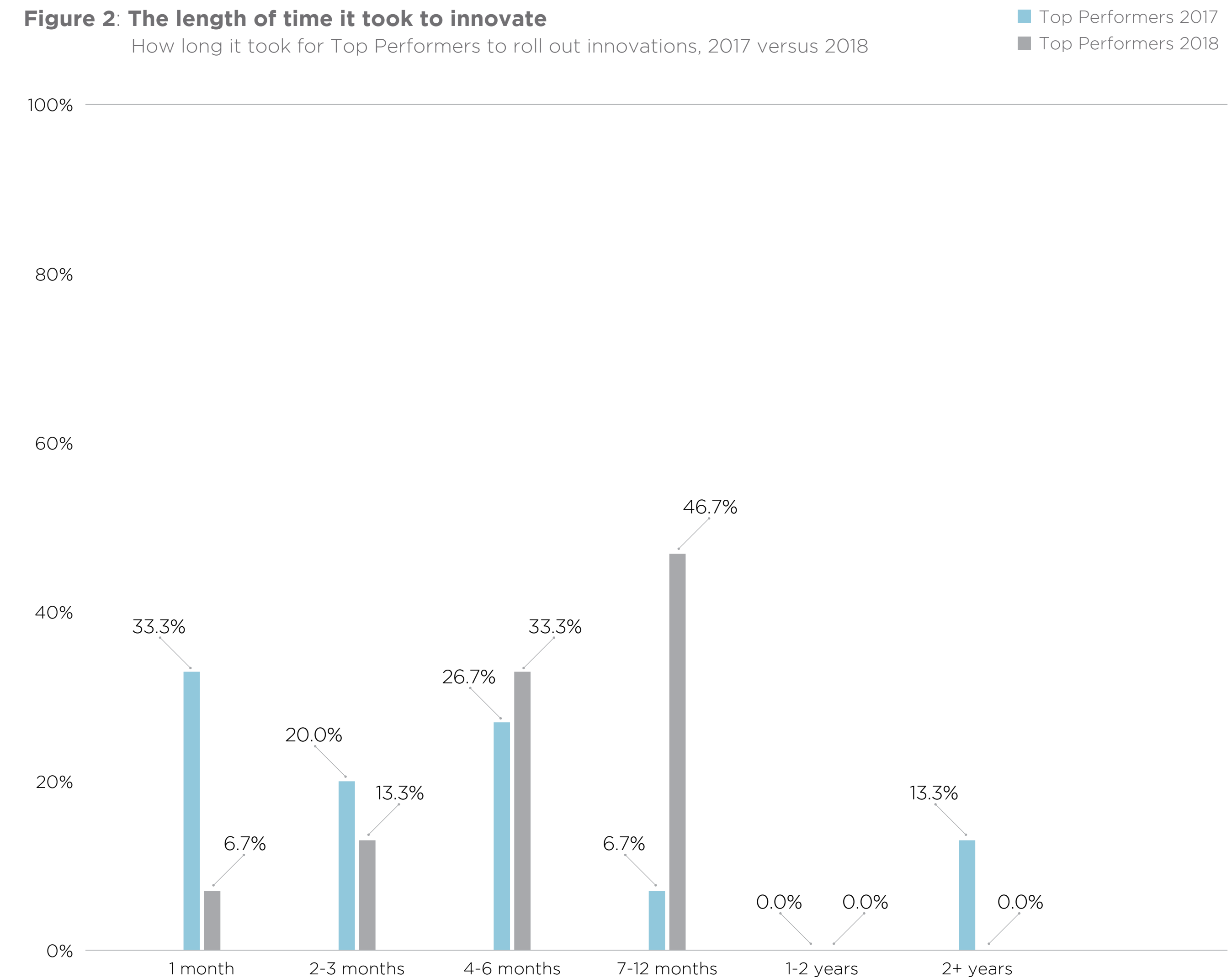
We saw the market backpedal on innovative readiness in 2018, with many FIs appearing to be in worse positions to innovate than just a year before. Our sample's average index score decreased considerably over that period, dipping from 2017's 37.8 points to 35.3 in 2018. The class was falling behind, but this time the top students were bringing down the curve.

In addition, the bottom students had become the ones to beat. Bottom Performers saw their average index score increase from 13.8 points to 19.3, meaning their ability to innovate improved by approximately 40 percent. On the flip side, Middle Performers' average remained relatively stable, decreasing only slightly from 35.6 points in 2017 to 35.0 in 2018.

Bottom and Middle performers had a decent year overall, but our Top Performers' collective index score saw a major decline from 66.0 in 2017 to just 55.4 in 2018 — more than enough to bring down the sample average. Thus, the performance gap between the best and worst innovators was beginning to close. The Top Performers were slipping while Bottom Performers, whose past performances had been lackluster at best, appeared to be stepping up their games.

The interesting part was what caused Top Performers' apparent 2018 decline: It was taking longer for them to release innovations into the market, and inflexible IT infrastructures were to blame.





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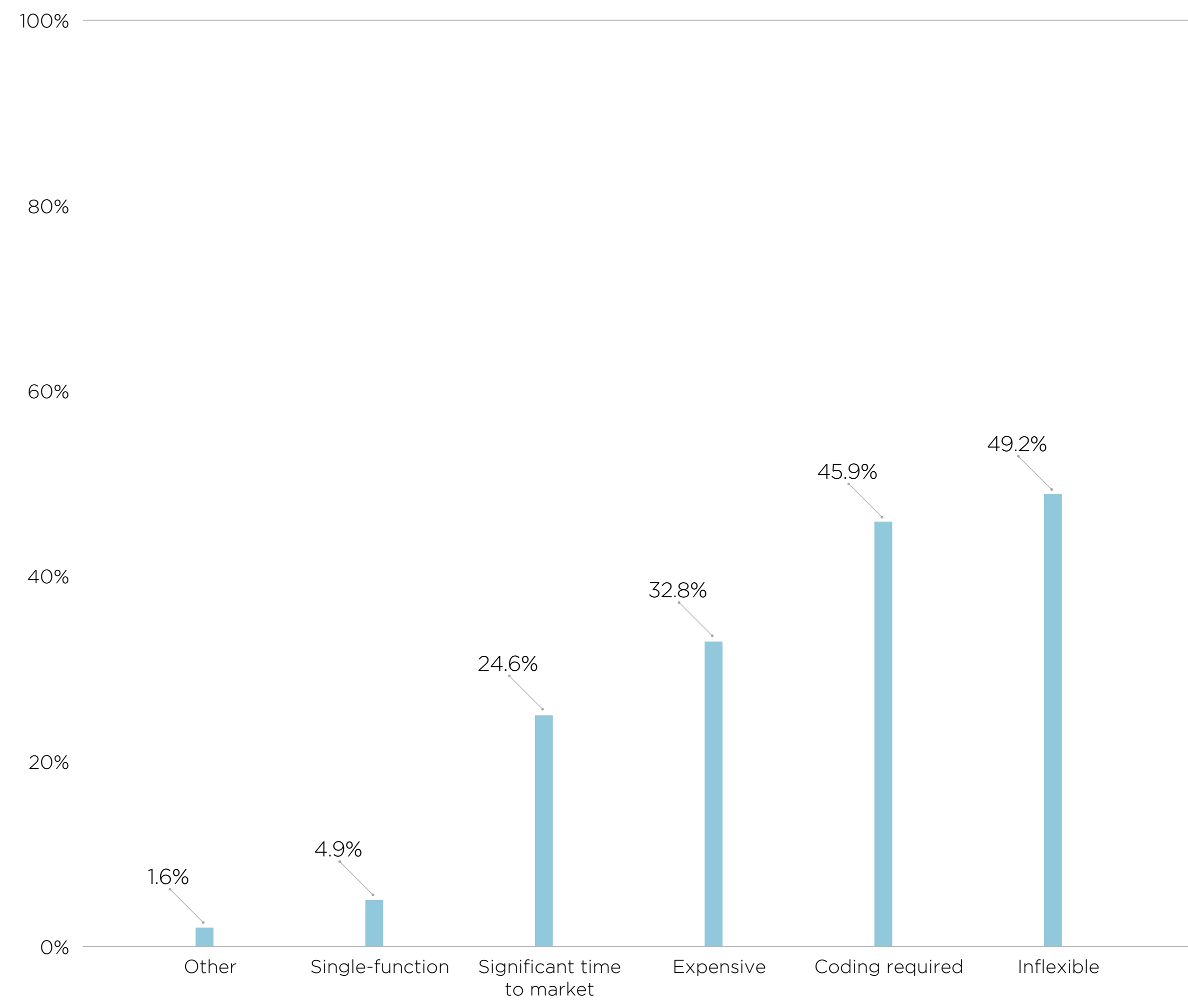
Approximately 39 percent of respondent FIs said their infrastructures facilitated easy innovation in 2017. That figure dropped to just 32 percent in 2018, meaning more of them were struggling with infrastructural problems in 2018 than in the year prior.

There are several ways in which core payment systems might affect businesses' innovation initiatives. The most common complaint, cited by 49.2 percent of the FIs in our study, was that their infrastructures were inflexible, hindering their ability to innovate in 2018.

Figure 3: **How FIs' core payments systems hindered payments innovations**
Portion that reported their core payments systems hindered innovations in select ways



The second-most common complaint about core payments infrastructure was related to the first: the need for more coding. If a system needs to be altered or improved, it generally requires edited or new lines of code. This can cost a considerable amount of time and money, which many FIs would understandably be reluctant to pay. Unfortunately, this reticence means they are generally stuck with the core processing systems they already have in place, creating a widespread demand for more agile technology platforms across the financial sector.

Such infrastructural stagnation was evident in how long it took FIs to release new products into the market this past year. As much as 86.7 percent of Top Performers completed their innovations earlier than originally scheduled in 2017, but the portion had dropped precipitously to just 26.7 percent by the end of 2018.

Moreover, FIs seemed aware that their infrastructures may have been slowing them down. When asked to identify specific factors hindering their projects, more cited IT infrastructure than any other obstacle. In fact, the portion increased from 36.3 percent in 2017 to 37.8 percent in 2018.

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Figure 4a: **Factors making innovations difficult**
Share of FIs saying select attributes make it difficult to innovate

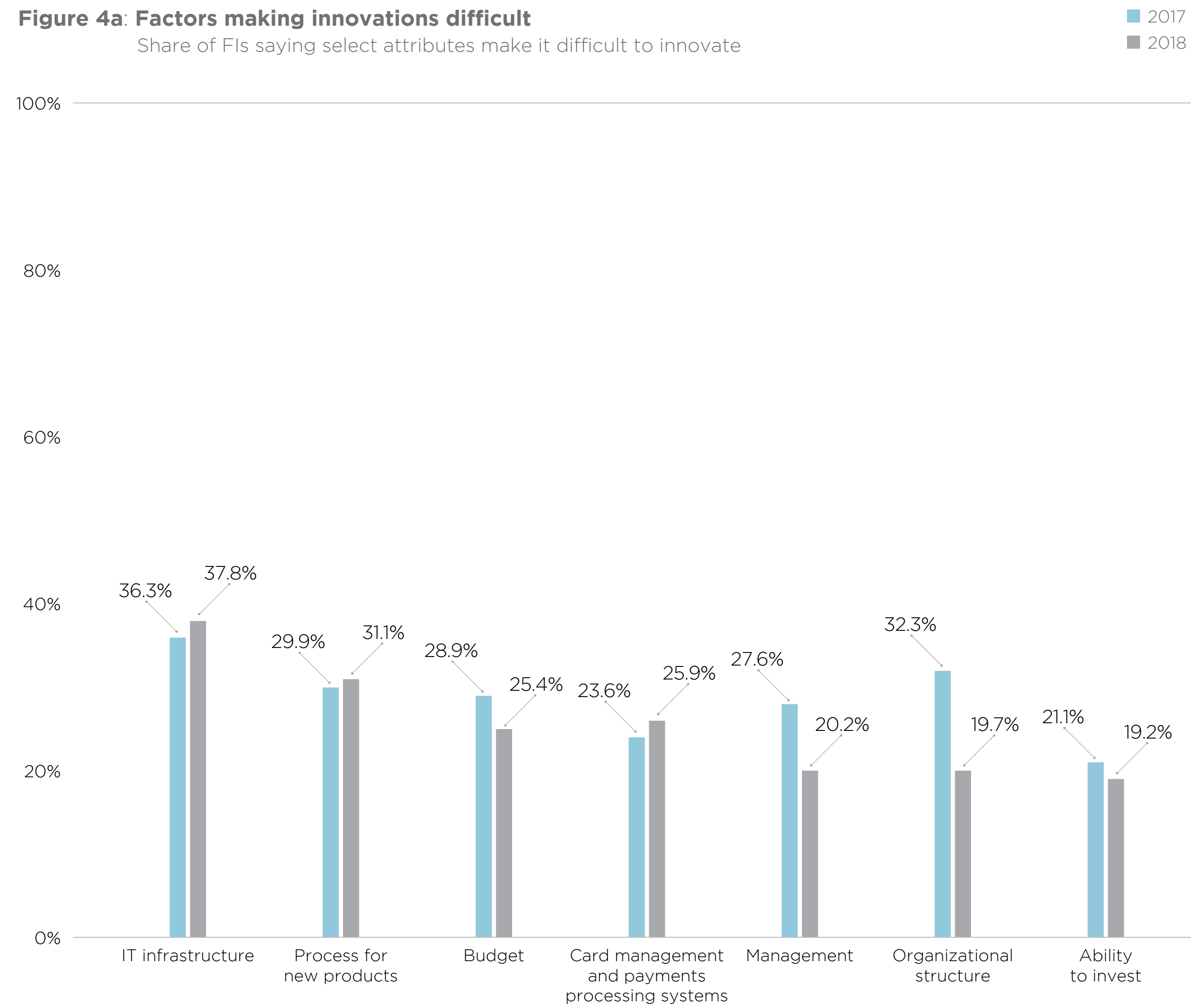
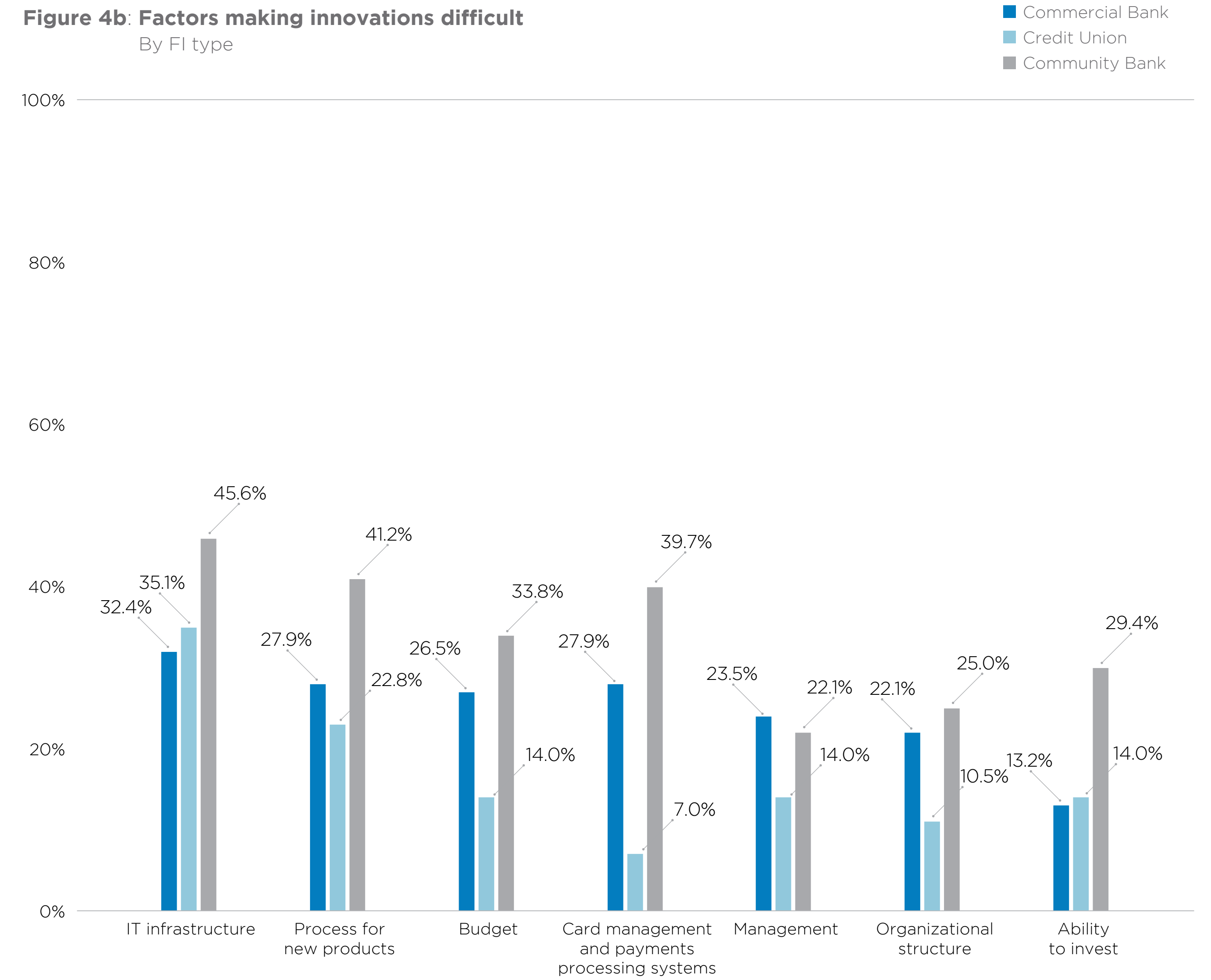


Figure 4b: **Factors making innovations difficult**
By FI type



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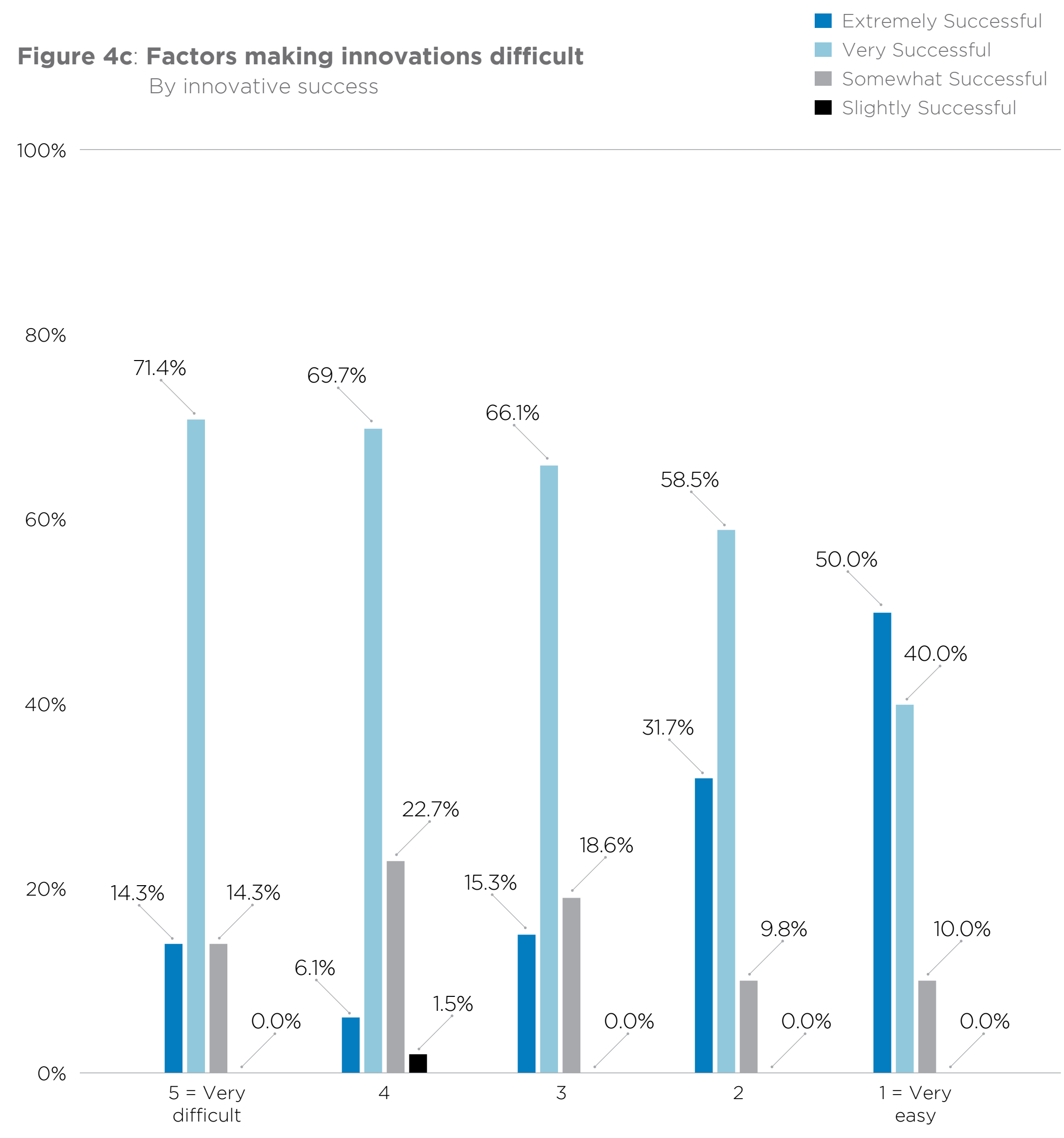


Figure 4c: **Factors making innovations difficult**
By innovative success

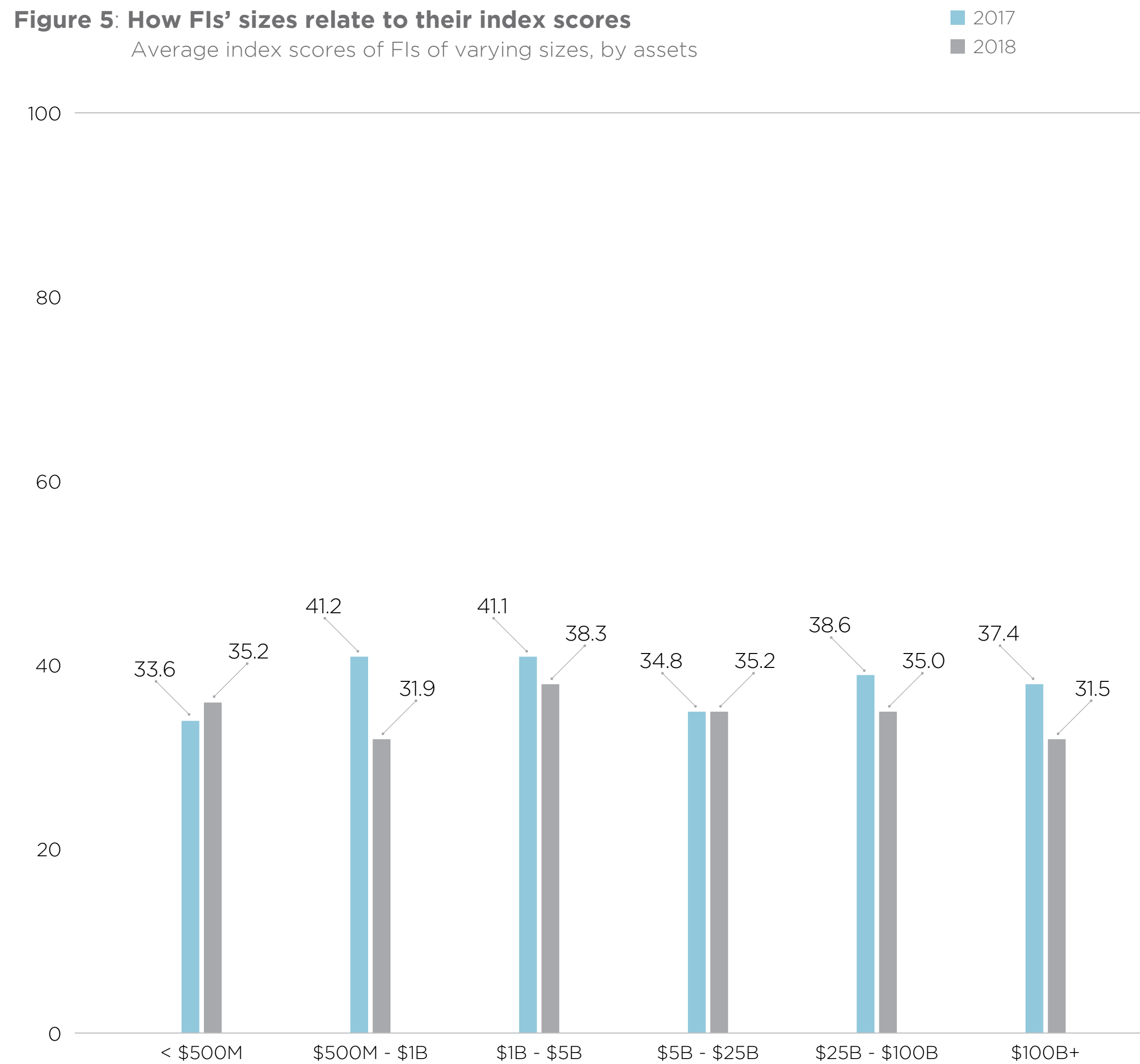
Interestingly, community banks were far more likely than commercial banks or credit unions to report that their IT infrastructures negatively affected innovation. Just 32.4 percent of commercial banks said infrastructure hindered their innovations in 2018, for example, but the portion was as high as 45.6 percent among community banks. In other words, community banks were approximately 33 percent more likely to report being burdened by inflexible IT infrastructures.

This makes intuitive sense. Commercial banks tend to generate greater revenues than credit unions or community banks. This often means they have larger budgets for developing more efficient core processing systems, and that they have the money they need to make the money they want.

That said, money was not everything. The largest FIs were not always the best at innovating — in fact, they were often the worst. Those holding more than $100 billion in assets earned the lowest average index score (31.5) of any group in 2018. This was below even the smallest FIs in our sample — those with fewer than $500 million in assets — which earned an average of 35.2 that year.

Overall, the best innovators were not the banks with the most assets or even the smallest operations, but those in the middle. FIs with $1 billion to $5 billion in assets had the highest average index score of any group at 38.3.

Figure 5: **How FIs' sizes relate to their index scores**
Average index scores of FIs of varying sizes, by assets



This group may have had the highest average index score, but it was not too much higher than those of the rest. The difference between the highest and lowest FIs of different size groups was just 6.8 points — nothing about which to write home. That scores varied so little when FIs were grouped by assets brought us to a more pressing point: When it comes to innovative success, size isn't everything.

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FUNDING AND THE PROBLEMS WITH
RISK AVERSITY

Money alone was no indicator of an FI's ability to innovate. Rather, success was more dependent on how they chose to use that funding. Investments made now earn returns later. Designing, developing and launching new features and products takes time, energy and, of course, money, and not all FIs have the resources to successfully roll out new products.

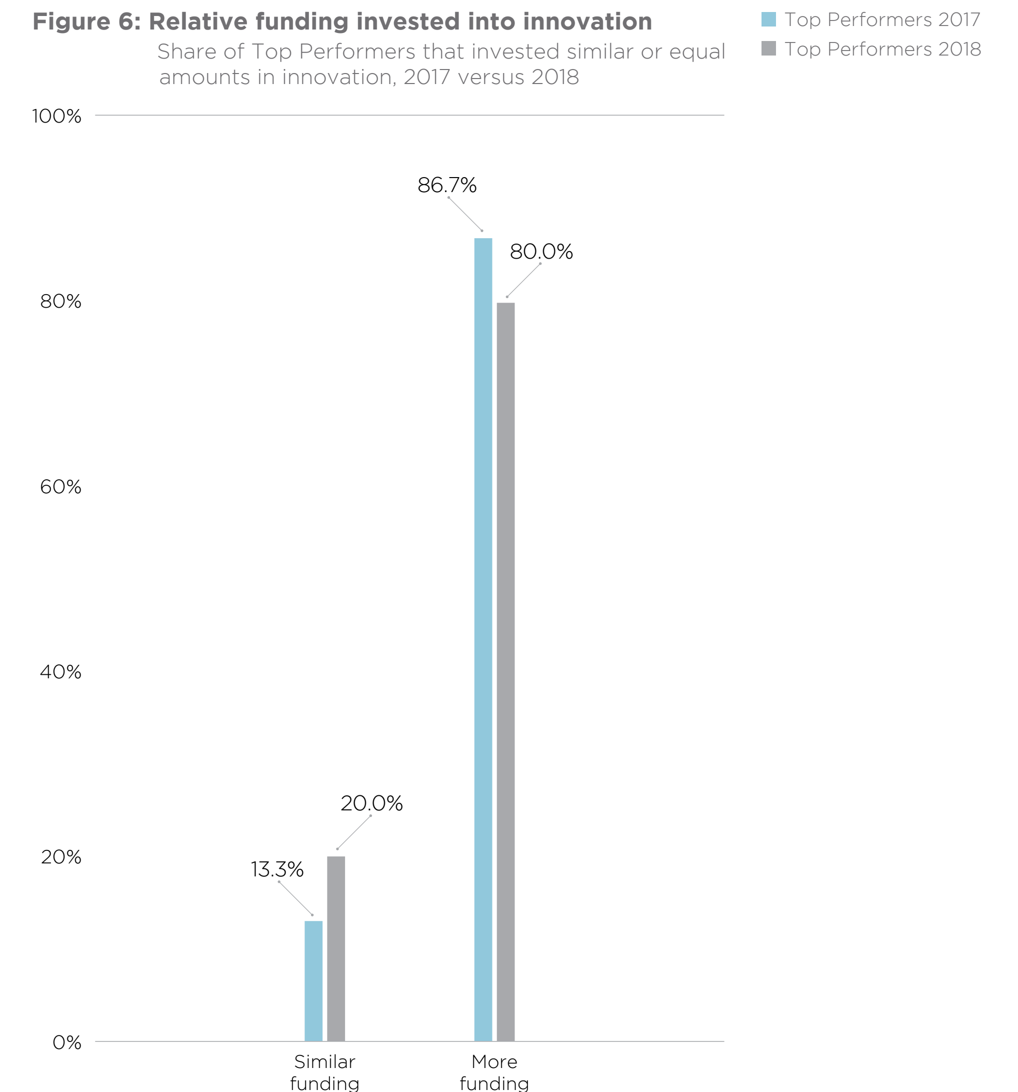
That said, their innovation troubles did not result from a lack of trying on the monetary front. FI leaders were certainly putting their money where their mouths were, and the amounts devoted to innovations have largely remained stable since 2017. They continued to invest large sums toward designing and implementing new innovations, too, though slightly less than in the past.

"In 2018, **80.0%** of Top Performers reported investing more funding in **INNOVATION THAN ALL other business areas.**"

The likely culprit behind the innovative lag witnessed in 2018 was not a lack of funding, but rather the mindset behind it. It largely championed risk aversion over innovation and appeared to be holding the best innovators back.

In 2017, 86.7 percent of Top Performers reported investing more funding in innovation than all other business areas. The portion fell to 80.0 percent in 2018, a minor but definite decrease, while the share that allocated similar funding to their innovation budgets remained relatively stable.

Figure 6: Relative funding invested into innovation
Share of Top Performers that invested similar or equal amounts in innovation, 2017 versus 2018



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These YoY changes seem slight, but they appear to indicate that the most innovative FIs' interest in funding new projects could shrink. Top Performers were running full speed into new innovation projects in 2017, but they were beginning to tap the brakes by the end of 2018.

One reason may have been that financial decision-makers struggled to connect the dots between investment and ROI. Innovation is expensive, and there are no guarantees that products will succeed. Moreover, it can be a frustrating — and expensive — experience when businesses spend portions of their hard-earned revenues on innovative projects that hit roadblocks.

This poses the risk that FI leaderships may begin to pull back their funding, worried that their teams may not be able to execute the plans already in place. Worse yet, plans that do fail can lend credence to such worries — even if poor performances were due to a lack of funding.

In addition, decision-makers at smaller FIs who decide their teams are not capable of executing planned initiatives may very well pull the plug on those in the pipeline. This has the potential to deteriorate the innovative competitiveness for all but the largest FIs in the market. Leaders must therefore try to avoid playing the "chicken and egg" game when funding innovation projects, as it is difficult to convince those that have decided their investments will not yield returns to spend more.

The question, then, is how are FIs to avoid getting caught in this cycle of cause and effect? The answer is simple, though execution proves surprisingly difficult for many: Focus less on managing innovation costs and more on adding value to customers' banking experiences.

ACTIVE VERSUS PASSIVE INNOVATION
APPROACHES

It is important to clarify that FIs should think more about meeting their current customers' demands, and not just about the interests of those they want to attract. Consumers drive FIs' innovative agendas. Banks are eager to capitalize on their rapidly changing demands, and thus looking to implement new innovations as quickly as possible. In this way, consumers play a significant role in the payments innovation process.

Meeting changing customer behavior was FIs' most-common reason for wanting to innovate almost all of their newest features and products. In fact, 68.2 percent of those in our study said they innovated or will innovate new credit products to meet changing consumer demand. This was not a general rule of thumb, but true for every product type FIs sought to innovate: Regardless of the solution, they were innovating it to keep on top of consumers' shifting demands.

Furthermore, our survey found that FIs seemed concerned with meeting potential clients' demands rather than those of existing clients. The desire to meet potential clients' needs was the second-most common reason that FIs innovated (63.0 percent). A considerably smaller portion (50.6 percent) said they innovated to meet those of existing clients.

In other words, the top three factors motivating FIs to innovate all centered on meeting consumers' expectations. It was just a matter of which consumers they wanted to attract. The issue was that many focused too much on meeting their current customers' demands, sometimes forgetting about those of their established clientele.

More interesting still was that FIs' priorities shifted with the consumer base to which they were trying to appeal. They tended to focus more on corporate credit card (65.0 percent), bill payment (64.8 percent) and home equity loan (64.7 percent) innovations when working to court new clients. In contrast, FIs placed greater emphasis on those for personal loans (54.7 percent), personal installment loans (53.9 percent) and working capital loans (52.8 percent) for existing clients.

It appears FIs believed that existing clients were content with the services offered, while potential clients needed to be won over with corporate credit card features and home equity services.

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The question became whether FIs were acting fast enough to beat their competition, or if other banks and credit unions were meeting customers' demands before they even had a chance to reach them. The truth was that most were not trendsetters, instead merely following the pack. However, they also liked to be as close to the head of that pack as possible.

By their own admission, 61.5 percent of FIs waited to see innovations' market reception in 2018 before investing in developing their own. Just 38.5 percent generally rolled out new products ahead of other FIs, meaning most were not unveiling new solutions in the hopes of creating new trends but hopping on their respective bandwagons as they came by.

Table 1: Factors that drove FIs to innovate

	Meet changing consumer behavior	Respond to potential clients' needs	Respond to existing clients' needs	Address digital and mobile market transformation	Become more profitable	Improve reputation	Bring more segmented product offerings to market	Respond to competitive threats	Enter new markets	Differentiate from competition
Consumer credit cards	71.5%	63.4%	48.9%	41.4%	40.3%	36.0%	25.8%	24.2%	18.3%	16.1%
Corporate credit cards	72.3%	65.0%	48.6%	40.7%	41.8%	36.7%	26.0%	24.3%	18.6%	13.0%
Bill payments	72.7%	64.8%	48.5%	37.0%	40.0%	37.6%	26.1%	24.2%	18.8%	13.9%
Home equity loans	70.0%	64.7%	50.0%	38.0%	38.0%	37.3%	28.7%	26.7%	19.3%	12.7%
Debit cards	68.1%	63.2%	50.7%	41.0%	38.2%	36.8%	27.1%	22.9%	20.1%	14.6%
Business installment loans	67.1%	62.1%	51.4%	39.3%	34.3%	31.4%	29.3%	29.3%	20.7%	16.4%
Personal loans	63.3%	61.9%	54.7%	36.7%	32.4%	37.4%	28.8%	27.3%	20.9%	17.3%
Revolving loans	66.4%	62.8%	48.9%	41.6%	36.5%	32.8%	26.3%	24.8%	21.2%	13.9%
Auto loans	66.9%	62.3%	50.8%	38.5%	34.6%	40.8%	30.0%	26.2%	22.3%	12.3%
Working capital loans	64.8%	60.8%	52.8%	40.8%	32.8%	31.2%	26.4%	28.0%	20.8%	13.6%
Personal installment loans	61.7%	60.0%	53.9%	35.7%	27.8%	35.7%	31.3%	28.7%	22.6%	16.5%
Average	**68.2%**	**63.0%**	**50.6%**	**39.2%**	**36.6%**	**35.9%**	**27.6%**	**25.9%**	**20.1%**	**14.6%**

Figure 7a: FIs' innovation rollout strategies
Portion of FIs that reported releasing innovations into the market at different times

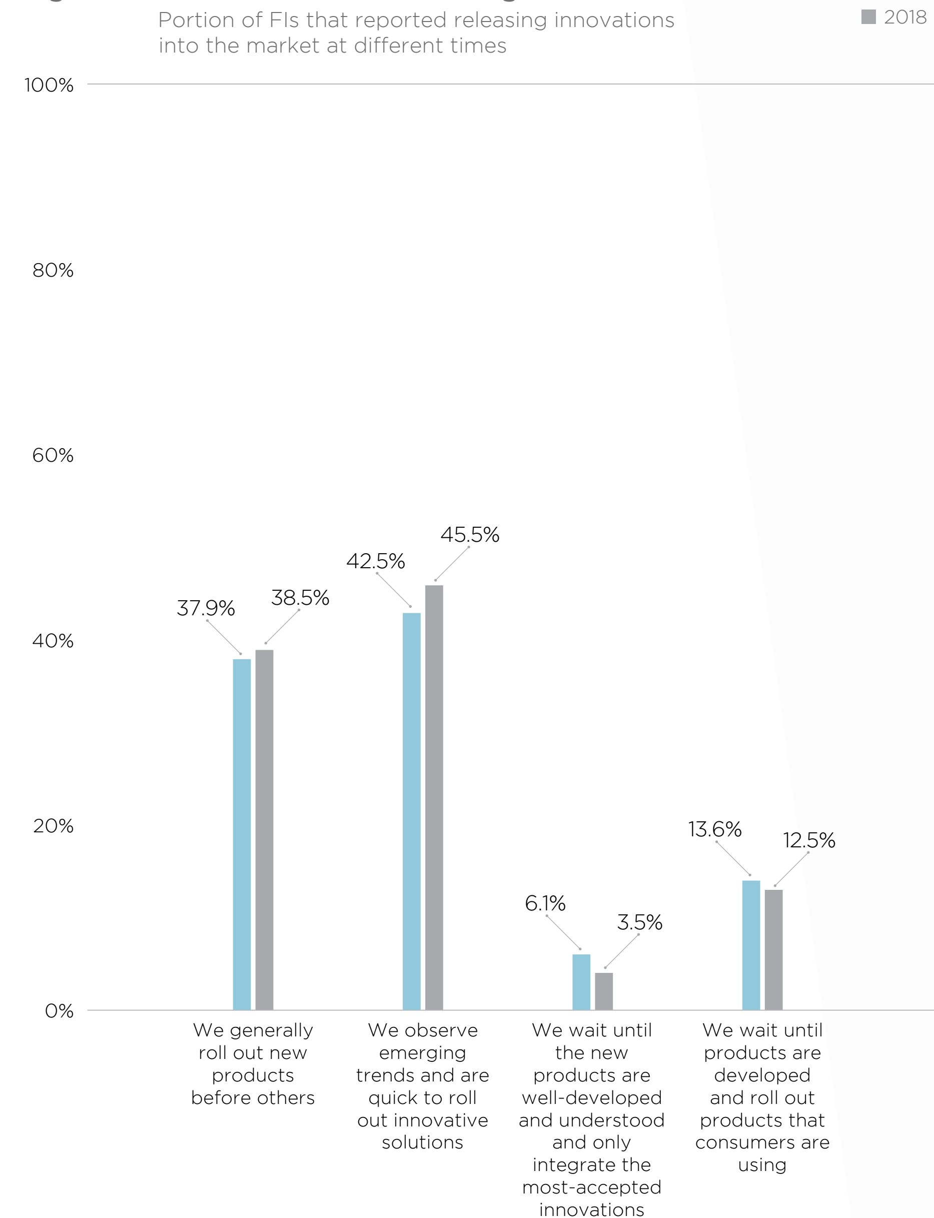
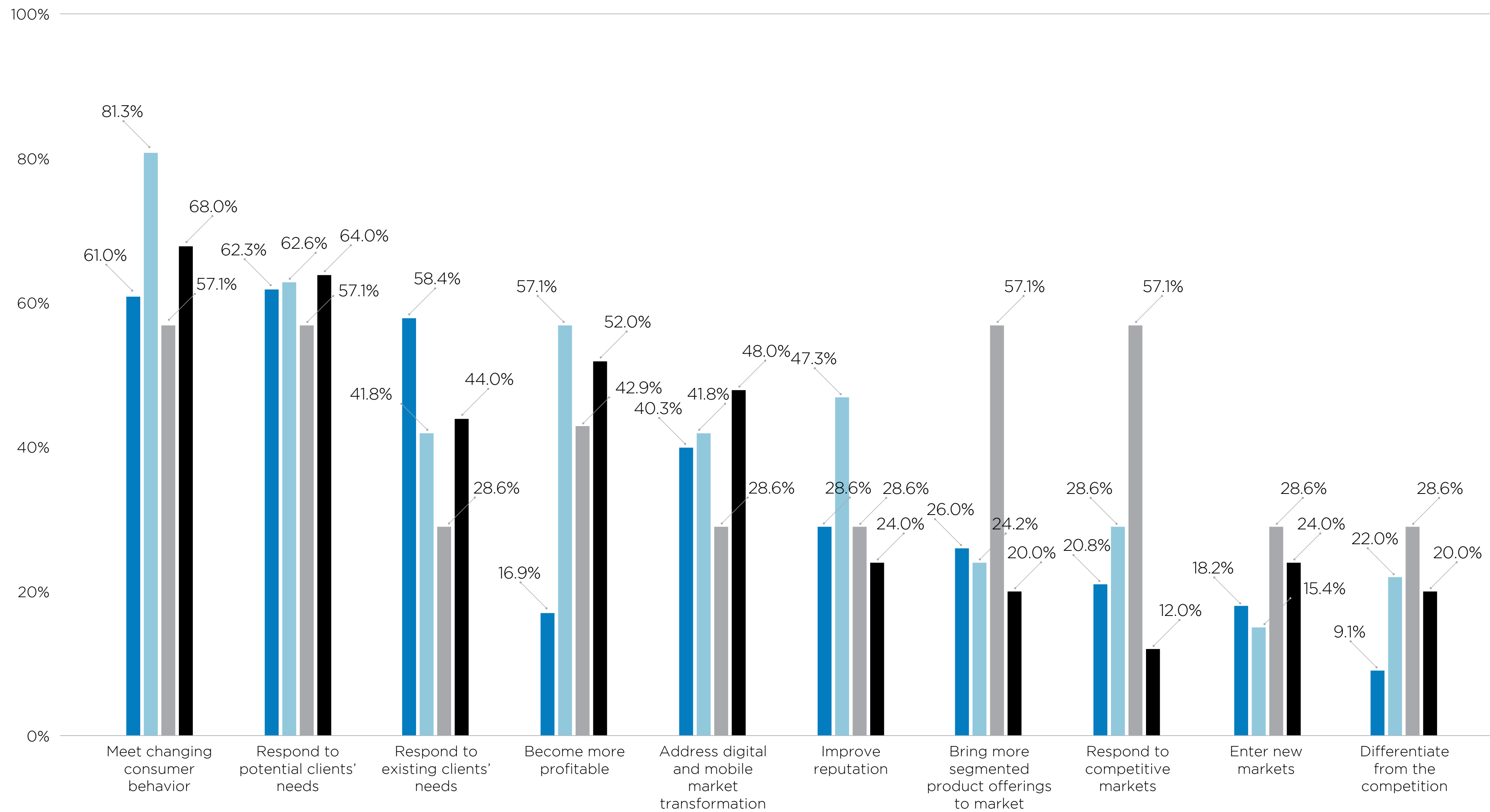


Figure 7b: FIs' innovation rollout strategies

Portion of FIs that cited select reasons for pursuing innovation, by release



There is a certain logic to this, of course: It is far riskier to invest time, energy and money into a project that has never before been released than to do so for one that has already achieved some degree of market success.

It is also harder to design a new product from scratch than to expand on or alter one that is already in the market. In this sense, FIs that opted to wait for their competitors to test new products first were hedging their bets, understandably wary of fully committing without some reassurance that it would produce returns — and enabling themselves to learn from their rivals' mistakes.

There are ways to test a new product's commercial viability without delaying its release, of course. One option is to invest in technology that allows a business to map customers' behaviors pertaining to new products. Tracking real-time usage lifecycles provides businesses with insights into how their customers experience their new products, allowing them to mitigate blind bet risks.

Even so, more FIs reported rolling out products before their competitors in 2018 than in 2017 at 38.5 percent and 37.9 percent, respectively. Those early to release innovations as soon as market trends were observed also increased, from 42.5 percent in 2017 to 45.5 percent in 2018.

Thus, we witnessed a slight uptick in the share of FIs committed to getting ahead of the curve on innovation rollouts — not to get ahead of their competition, necessarily, but rather to keep up on consumers' rapidly shifting demands. This puts them between a rock and a hard place. FIs felt pressured to quickly release innovations to catch up with their potential customers' needs, but they did not want to waste their precious time, energy and resources rolling out innovations that would not perform well commercially.

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Luckily, there were ways they could ensure an innovation's commercial viability. Many companies ran tests on new products and features before selling them, using a variety of methods to gain a sense of a solution's viability before it launched. Most trialed new innovations with employees, reported by 64.0 percent of FIs in 2018. The second- and third-most common methods were to test innovations with customers (57.0 percent) and build their own tools and products (40.5 percent).

This strategy can be particularly useful when the products are completely new, providing decision-makers an idea of how solutions might perform before they put their financial necks on the line.

Figure 8a: How FIs test products and features before release
Portion of FIs that used select methods to test new products or features

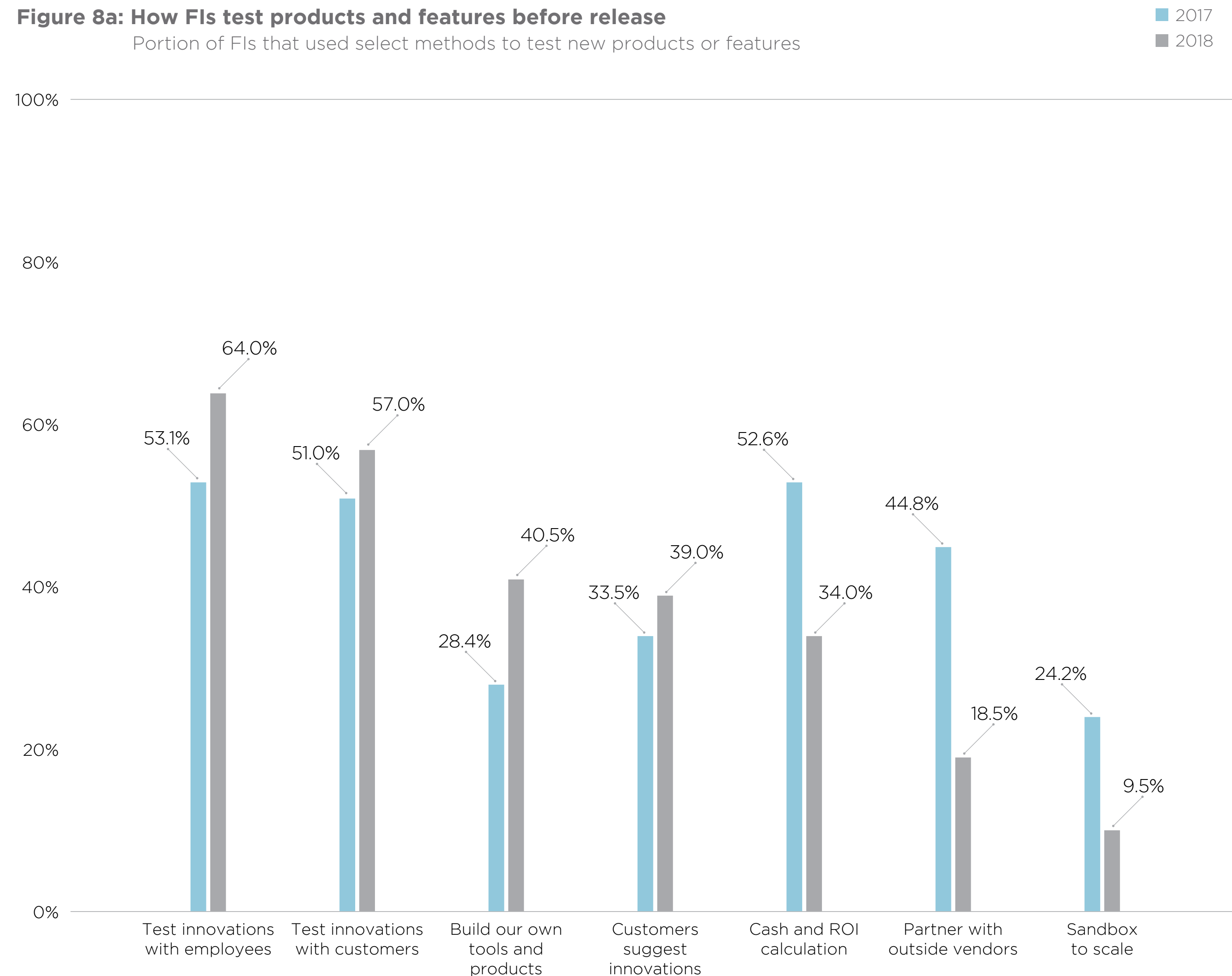

Figure 8b: How FIs test products and features before release
Portion that reported successful innovation rollouts in 2018

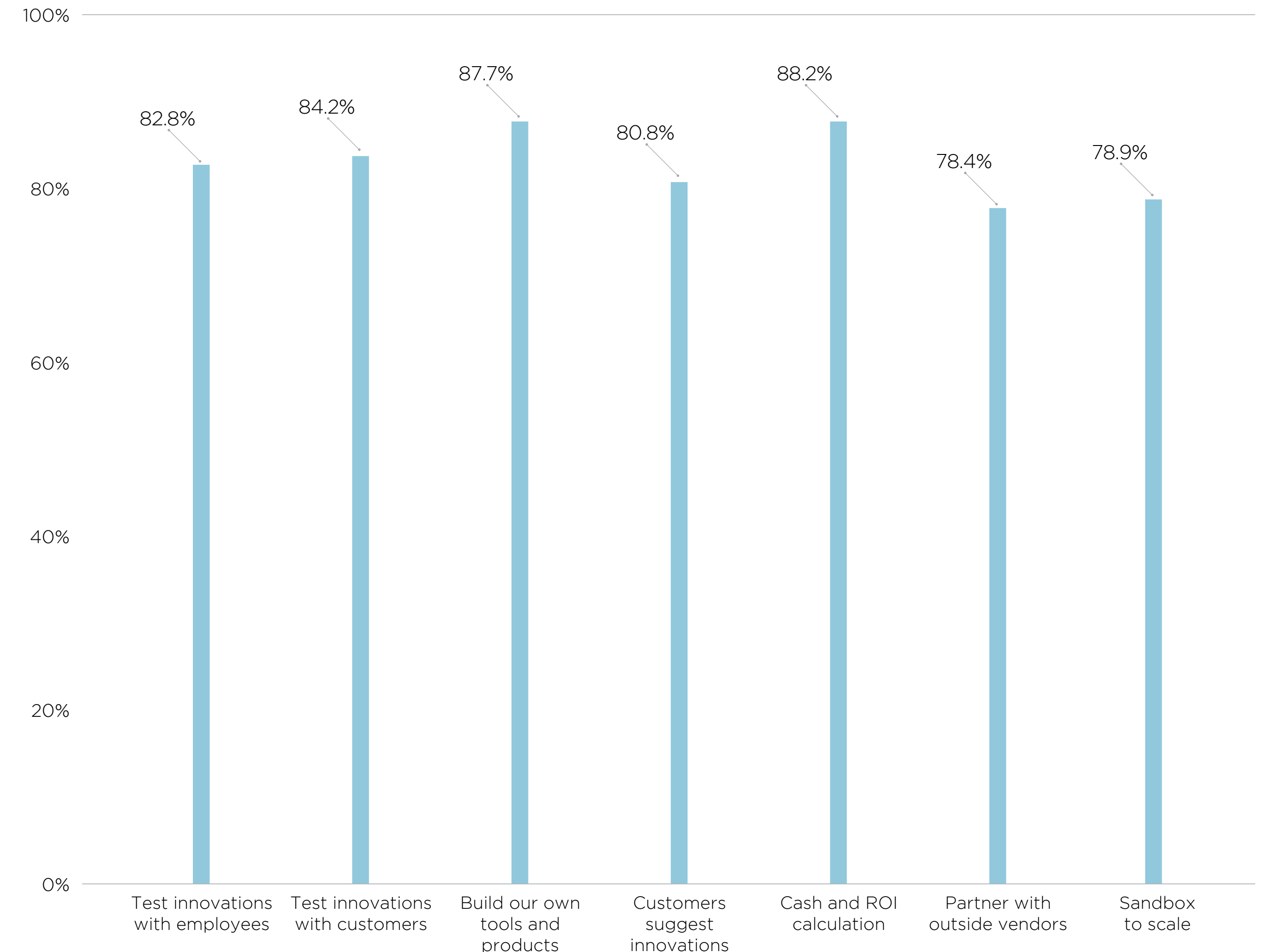

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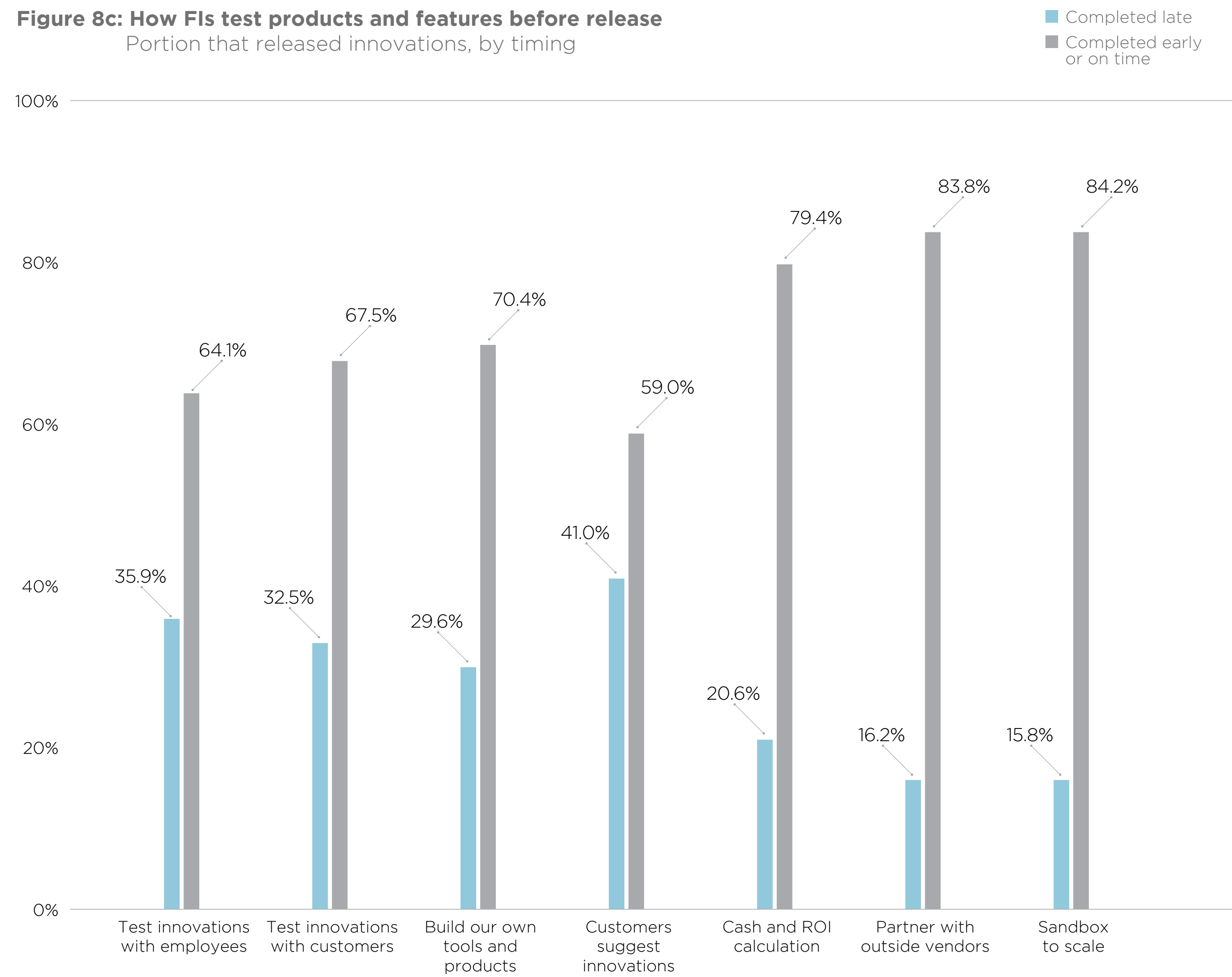
Figure 8c: How FIs test products and features before release
Portion that released innovations, by timing



Regardless of the methods used, a clear majority of the FIs that took the time to test innovations before releasing them reported having successful rollouts. Those that trialed new products and features by running their own cash and ROI calculations beforehand had the highest success rates at 88.2 percent, for example, followed by 87.7 percent that built their own tools and products and 84.2 percent that tested new products with customers.

The potential downside to testing before releasing is that it takes more time. This was an issue for the 41.0 percent of FIs in our study that allowed their customers to suggest new innovations first, as they reported completing their innovations late as a result. It appears 35.9 percent of those that tested new products with employees also launched their innovations behind schedule, though the portions were considerably smaller among FIs that used sandbox-to-scale testing (15.8 percent) or partnered with outside vendors (16.2 percent).

In the end, it was clear that most FIs would rather risk having projects launch late than stick to a schedule and roll out bad ones. The real difference lay in the strategies they employed to help ensure their products were good. Most FIs were reactive to market trends, rather than proactively setting the pace. Some preferred to let the market vet out the non-profitable ideas, while others preferred to take active roles by testing solutions internally before releasing them. Still others used a combination of these techniques.

Finally, it is crucial remember to focus not only on acquiring new customers, but also on keeping their old ones when putting these strategies into place. Gaining new clientele means nothing if they do not stick around in the long term, after all.

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CREDIT, CREDIT AND MORE CREDIT

“More than 78 percent of FIs reported

40%

or more of their revenue came from bill payments, **making them the third-most common innovation area.**”

As important as it may be to gain and retain customers, FIs generally do a poor job of differentiating their innovations from their competitors'. There is not much diversity in the products and feature types they produce. Most focus their efforts on the same key areas: credit products for consumers and small- and medium-sized businesses (SMBs), the most profitable for their firms.

The two largest innovation areas were consumer and corporate credit cards, respectively. This was hardly surprising, as 75.4 percent of FIs said the latter generated 40 percent or more of their revenue, and 75.2 percent said the former did the same. In addition, 78.5 percent of FIs reported 40 percent or more of their revenue came from bill payments, making them third-most common.

As always, the story was more complicated. FIs of certain sizes and types were more likely to focus on these big-three areas of innovation. The smallest and largest in our sample were the most prolific consumer and corporate credit card innovators. Ninety-six percent with more than $25 billion in assets reported innovating new consumer credit cards, as did 95.7 percent of those with fewer than $500 million. The figures were similar for FIs that innovated new corporate credit card products.

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Figure 9a: FIs' priorities when innovating select credit products

Share of revenue generated by select credit products

	<10%	10-40%	40-60%	60-90%	>90%
Personal installment loans	4.2%	20.8%	43.8%	30.2%	1.0%
Working capital loans	7.5%	22.6%	41.5%	26.4%	1.9%
Revolving loans	6.7%	18.7%	41.3%	32.0%	1.3%
Home equity loans	4.8%	16.3%	40.4%	37.5%	1.0%
Business installment loans	4.5%	17.3%	42.7%	32.7%	2.7%
Auto loans	6.3%	20.7%	37.8%	34.2%	0.9%
Debit cards	5.5%	20.9%	43.6%	28.8%	1.2%
Personal loans	5.0%	20.6%	43.3%	29.8%	1.4%
Bill payment	4.4%	27.2%	38.6%	28.1%	1.8%
Corporate credit cards	6.7%	17.9%	39.6%	33.6%	2.2%
Consumer credit cards	4.7%	20.1%	46.2%	27.8%	1.2%

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Figure 9b: FIs' priorities when innovating select credit products

Share of FIs that invest in select credit products, by assets

	>$25B	$1B - $25B	$500M - $1B	<$500M
Consumer credit cards	96.0%	91.0%	92.3%	95.7%
Corporate credit cards	96.0%	89.9%	82.1%	87.2%
Bill payment	80.0%	84.3%	82.1%	80.9%
Personal loans	88.0%	65.2%	46.2%	87.2%
Debit cards	76.0%	71.9%	64.1%	76.6%
Auto loans	76.0%	62.9%	46.2%	78.7%
Business installment loans	96.0%	64.0%	59.0%	76.6%
Home-equity loans	76.0%	75.3%	76.9%	72.3%
Revolving loans	84.0%	60.7%	69.2%	74.5%
Working capital loans	88.0%	59.6%	41.0%	72.3%
Personal installment loans	72.0%	51.7%	38.5%	76.6%

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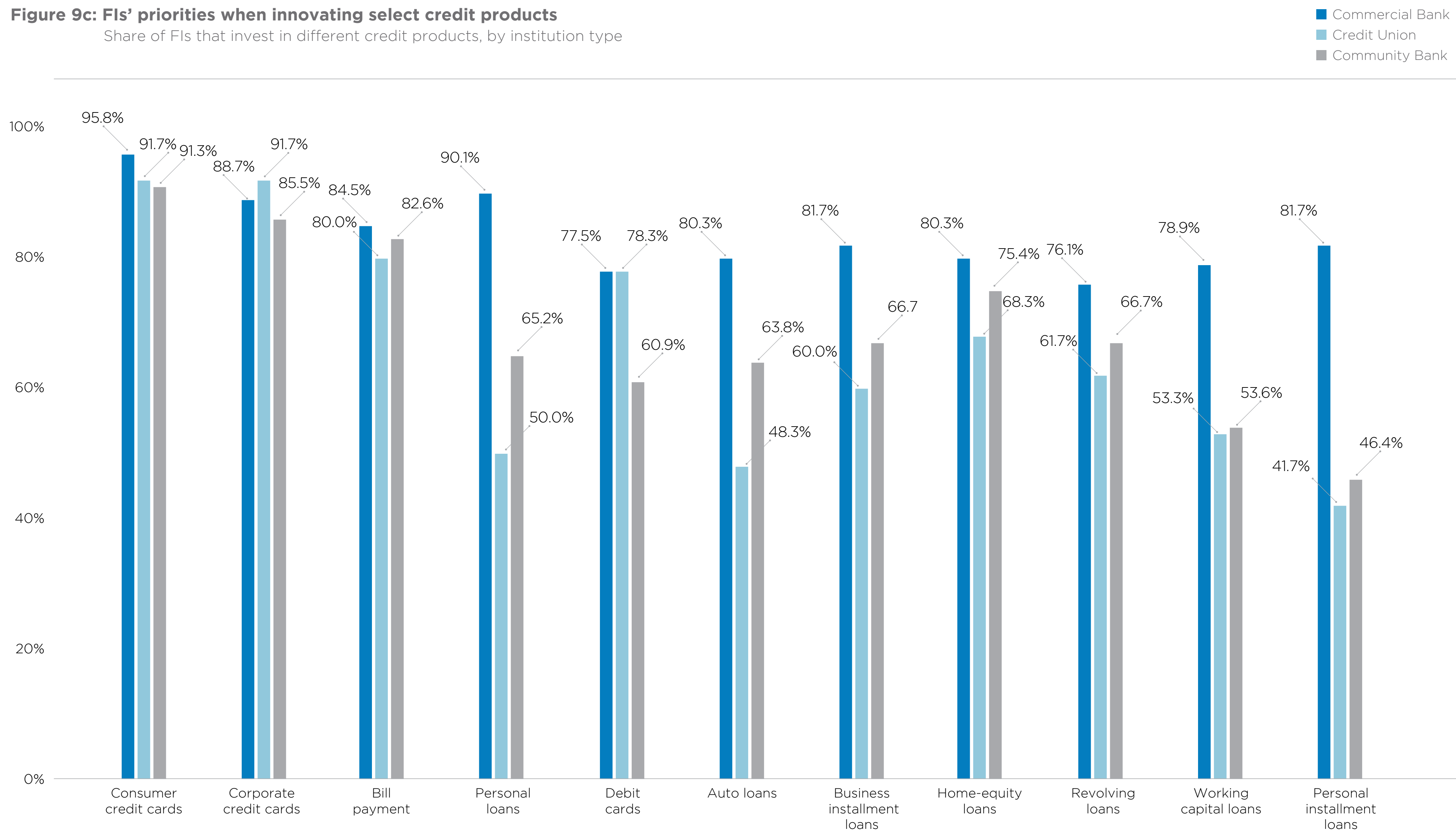
Figure 9c: FIs' priorities when innovating select credit products

Share of FIs that invest in different credit products, by institution type



Interestingly, different FI types tended to focus on different features. Commercial banks focused more on innovating features and products centered on bill payments, personal installment loans and working capital loans than community banks and credit unions. In fact, they were more likely than other FI types to innovate in nine of the 11 innovation areas studied.

Corporate credit cards and debit cards were the only two areas in which credit unions were more prolific innovators than commercial banks. We found that 91.7 percent rolled out corporate credit card innovations in the past three years, compared to 88.7 percent of commercial banks. In addition, 78.3 percent of credit unions released some sort of debit card innovation during the past three years, as did 77.5 percent of commercial banks. Community banks seemed to be the laggards here, as they did not produce one innovation type more frequently than their counterparts.

There was also correlation between the type of products FIs innovated and the features on which they focused. Companies that innovated consumer credit cards also tended to emphasize

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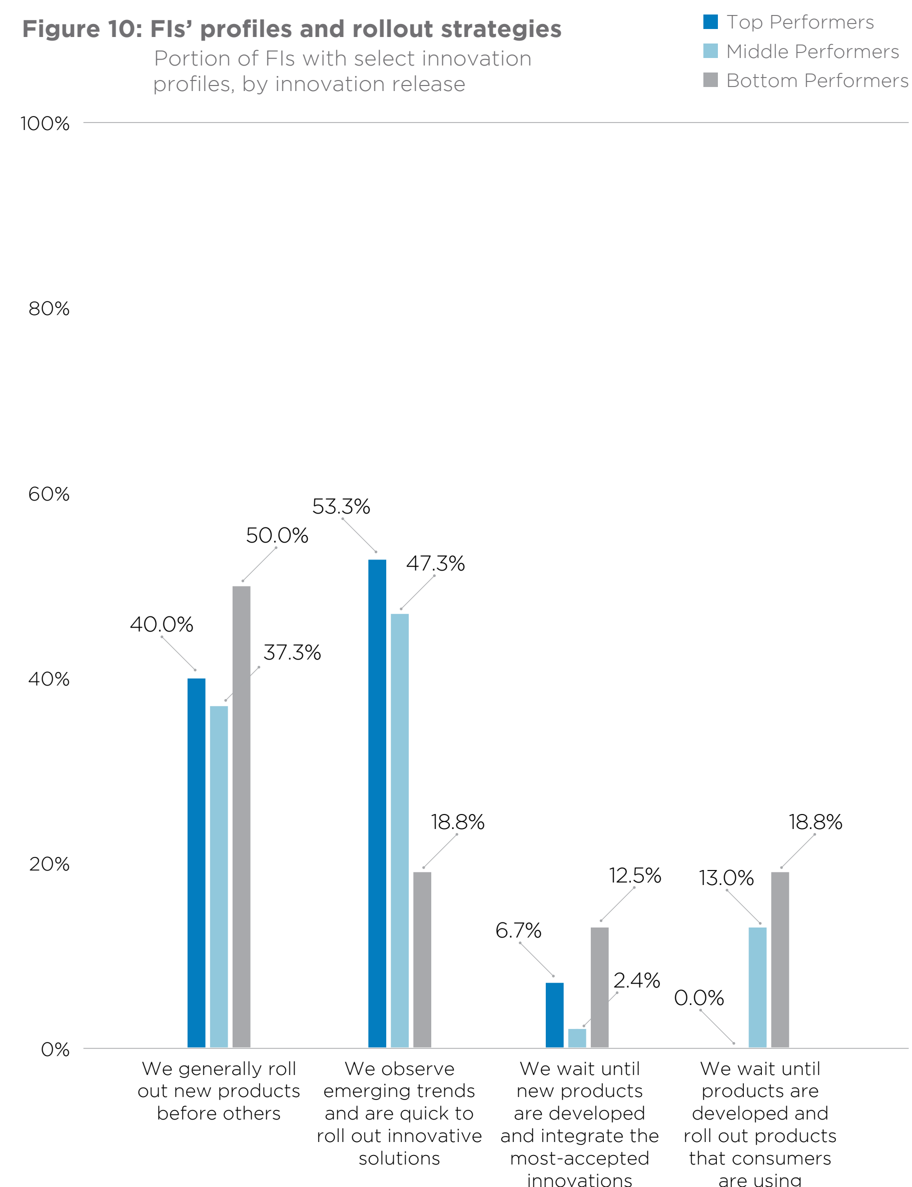
fraud and security (65.6 percent), loyalty and rewards (55.9 percent) and mobile (59.1 percent) features. FIs that put their energy into credit card innovations often did the same.

The real question, of course, was why so many different FIs types focused on innovating similar innovations. Simply stated, they wanted to remain competitive.

Yet, many FIs did not actually report being motivated by competition. As seen in Table 1, just 25.9 percent said they innovated in response to competitive threats, and even fewer (14.6 percent) did so to differentiate themselves from their competition.

Another hint that FIs were innovating to keep ahead of their competitors was that 47.6 percent generally rolled out new features before others. The quicker new products and features hit the market, the less competition they face from those of rival FIs, after all. Beating the clock is a type of competition, too — just a less direct one.

Interestingly, when we actually examined which FIs tended to release products first, we noticed that Bottom Performers were the most likely to roll out their innovations before competitors. Half of them said this was the case, while just 40.0 percent of Top Performers took this route. Top Performers were more likely to observe emerging trends and then quickly roll out innovative solutions, with 53.3 percent saying this was how they timed their releases. Middle Performers were similar, with 47.3 percent observing trends and completing innovations shortly thereafter.



This gives a very clear picture of a typical financial market innovation cycle: Bottom Performers and a fair share of Top Performers are typically first to introduce new technologies or services. Then, once that first wave is unveiled, the rest of the Top Performers observe what works — and what doesn't — before investing in what has been successful. The remaining FIs are left doing their best to compete among themselves to capture the rest of the market.

This makes sense, but delaying too long to observe market trends becomes a costly game when most FIs are innovating in the same areas.

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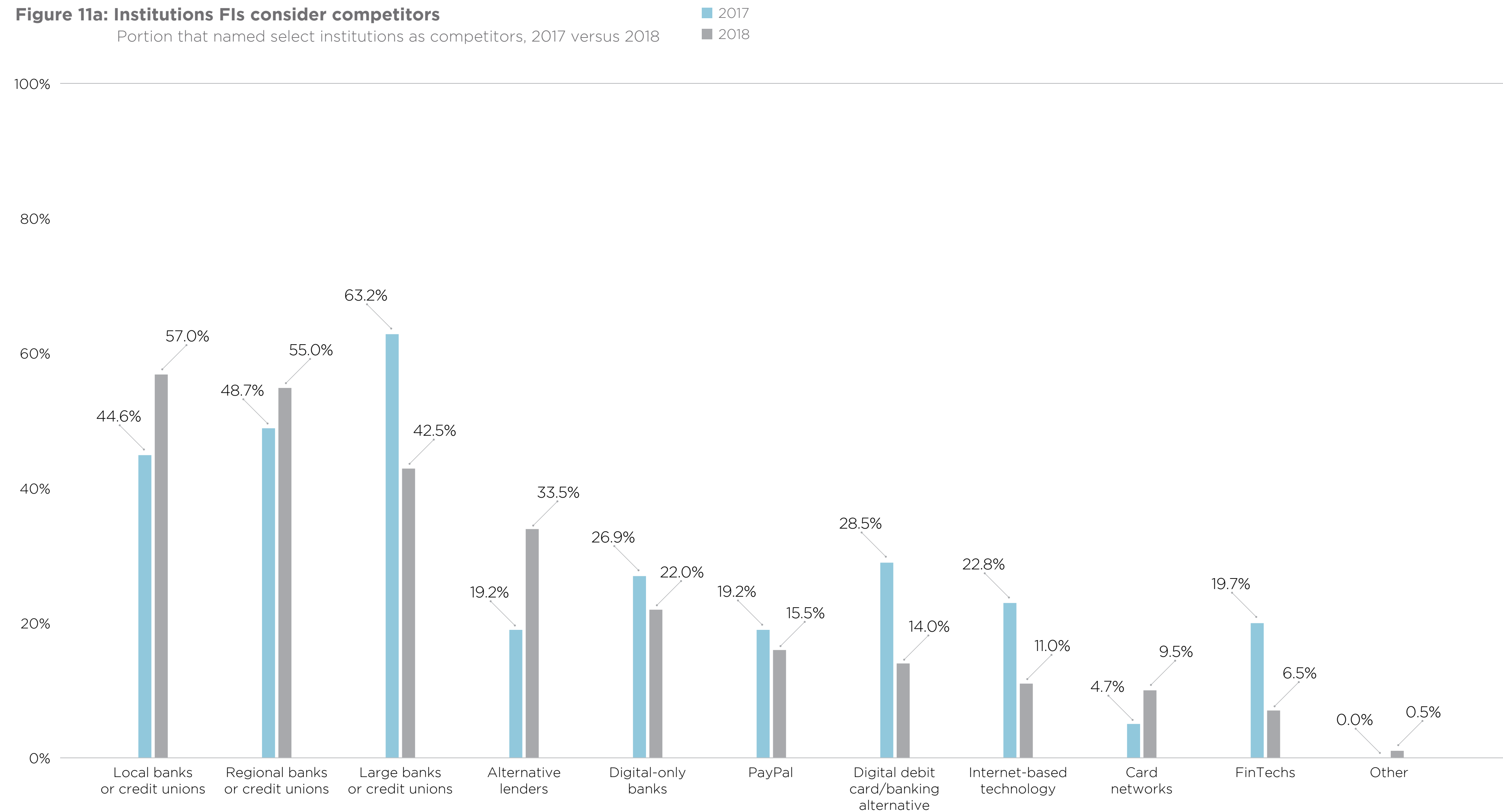
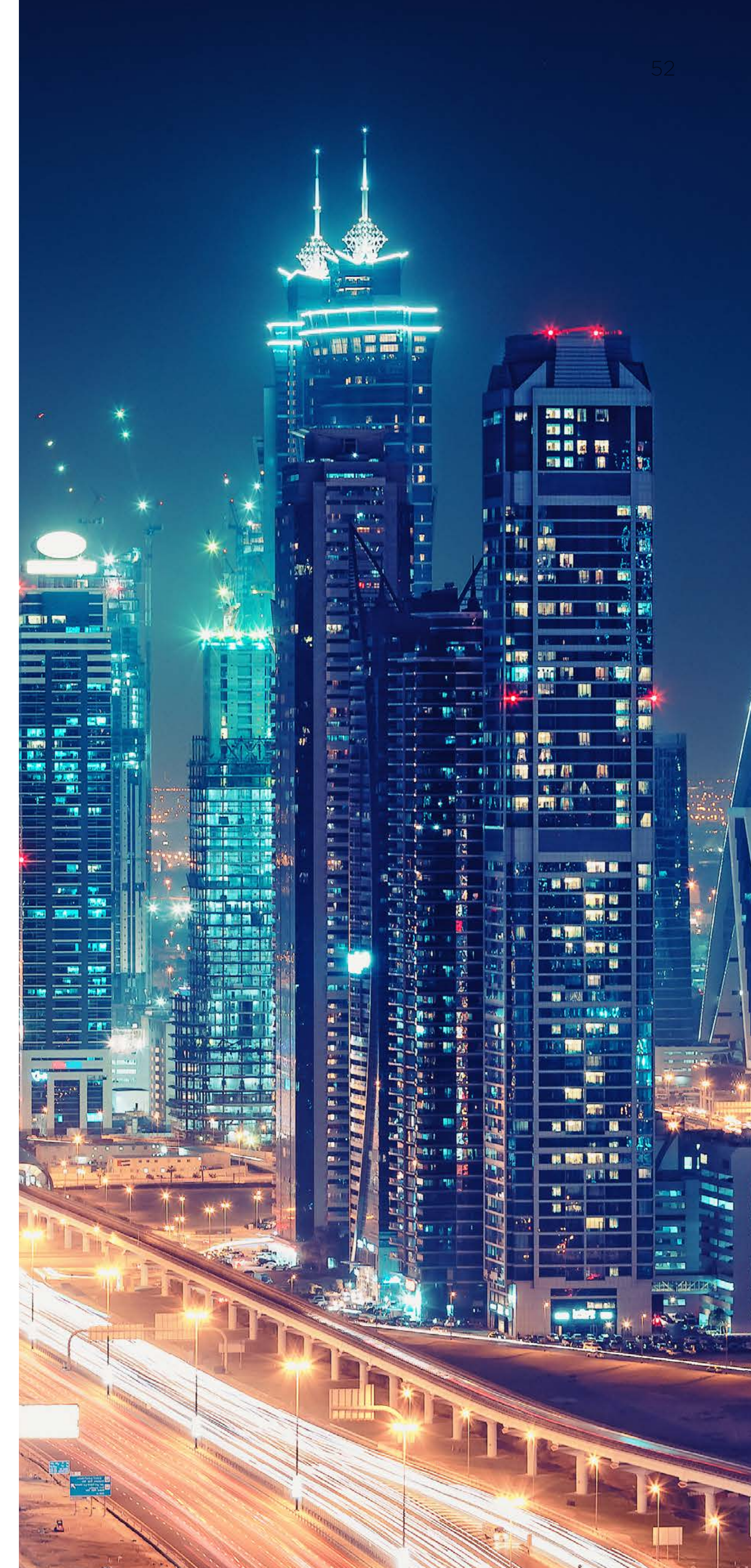
RISKING A NARROW VIEW OF

COMPETITION

FIs have a competitive blind spot, and it's keeping them from seeing FinTechs as their competitors. Approximately 63.2 percent said their biggest competitors were either national banks or credit unions in 2017, and 57.0 percent said the same of local banks and credit unions in 2018. Just 6.5 percent of respondent FIs from our most recent survey considered FinTechs to be competitors.

Figure 11a: Institutions FIs consider competitors
Portion that named select institutions as competitors, 2017 versus 2018





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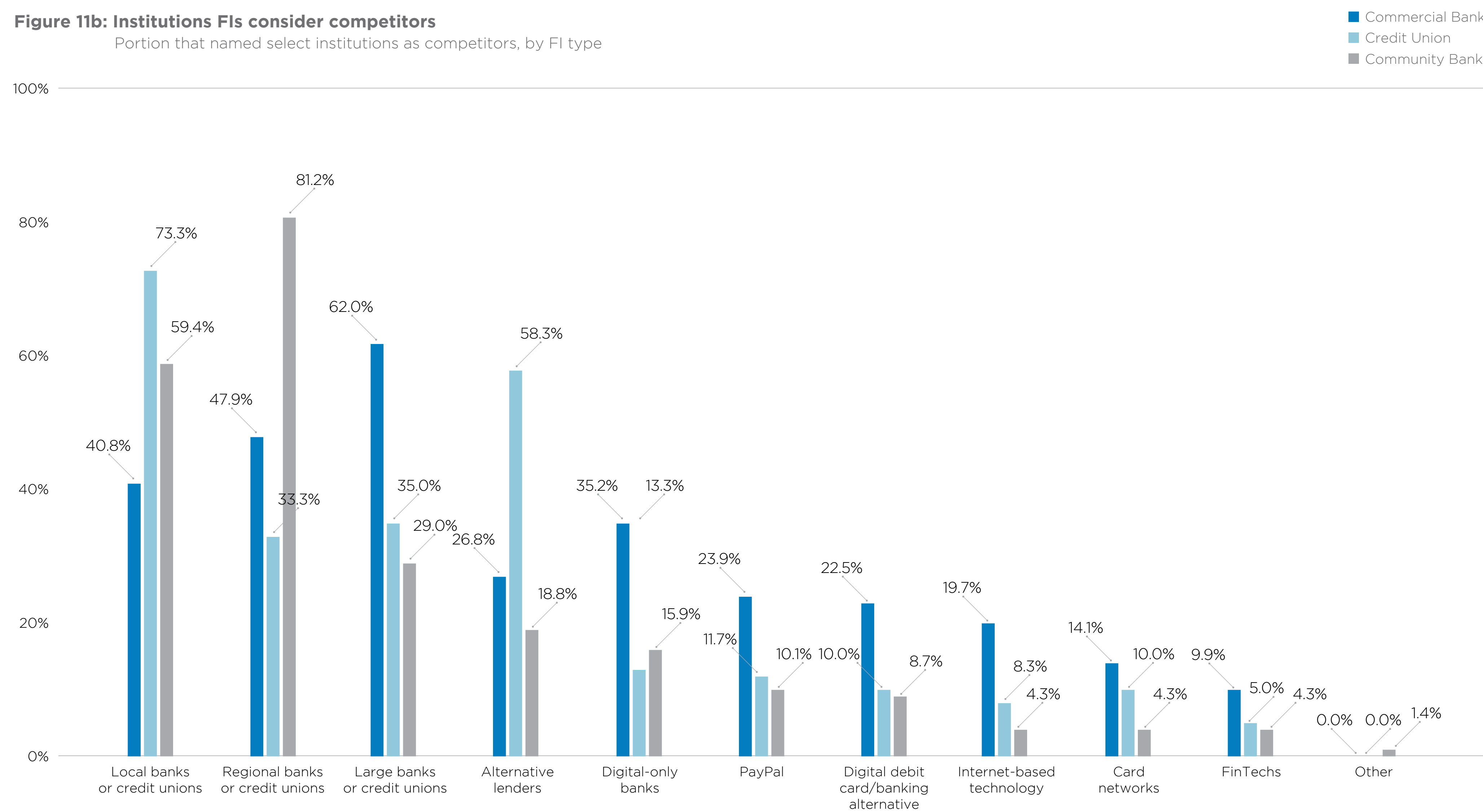

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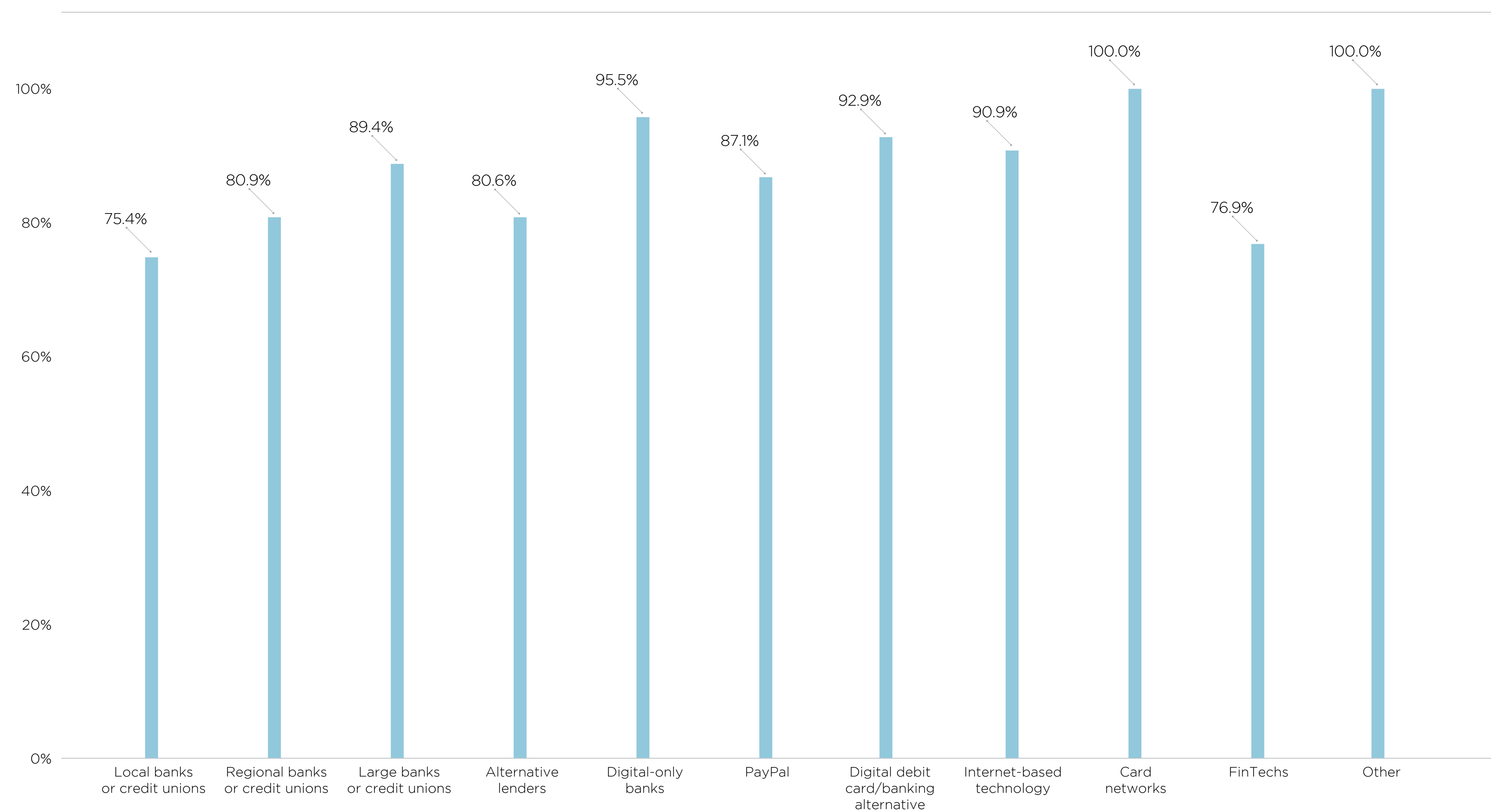
Figure 11c: Institutions FIs consider competitors

Portion that said their innovations had been successful in 2018



This is ironic, considering so many FIs are focusing efforts on credit innovations for consumers and SMBs, both of which see fierce competition from FinTechs. Amazon, Kabbage and Square are just a few of the companies making headlines by playing the roles of banks, earning customers by providing individuals and SMBs with innovative credit products.

In short, FinTechs are homing in on most FIs' bread-and-butter areas, but banks don't seem to realize it. This could cost them in the long run if they don't act fast.

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CONCLUSION

FIs with scale and those in specific product or customer-focus niches had the financial and other resource-related capabilities to capture the ROI for which they were looking. Meanwhile, Middle Performers who were forced to compete with both ends of the spectrum were more vulnerable and slower to introduce new features and products — but not so slow that they missed their marks. In many ways, successful innovation appears to chiefly be a matter of proper timing and coordination.

Going forward, FIs would do well to keep in mind that the best innovators are not those with the largest budgets or fastest time to market, but rather those that invest their time and money wisely. The most successful put their energy into planning and testing new products and features before unveiling them, ensuring their solutions are in shipshape before they are shipped out.

If they don't, the market is full of ambitious FinTechs eager to capture their customers.

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