

P E R S P E C T I V E

How Small Banks are Innovating



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When it comes to innovativeness, small banks have shown that size does not matter. Small banks, which we define as those with less than US\$ 10 billion in assets for the purpose of this paper, typically include the likes of Credit Unions and Community Banks in the U.S., Building Societies in the U.K. and Co-operative Banks in India. (Some of these do have a larger presence and balance sheet, but they are the exception rather than the rule). That being said, these banks have a lot more in common, such as a co-operative structure, membership-based model and an aversion to risk.

Forced to compete against the biggies on the same terms, these institutions have overcome many hurdles with an innovative approach. Before we understand how they've gone about this, let's take a quick look at the challenges they face:

- Small banks receive no concessions for their size, and generally have to adhere to the same rules and regulations as large banks.
- They lack clout and have limited financial resources to spend on marketing, distribution and other things.
- Since they operate within a restricted geographic area, they are unable to roll out a wide suite of products to a huge customer base.

Small banks have some unique advantages.

But it's not all bleak, and small banks do have certain advantages which they must continue to capitalize on.

Trusted relationships: Because credit unions, community banks and co-operatives are funded by their members who are also the users of products and services, they form much closer 'customer' relationships. It is for this reason that these banks continue to enjoy a high level of trust.

Strong 'community' identity: Small banks' limited geographic reach is their blessing in disguise - by concentrating all their activity within a region, they have built a strong identity and relationships among the local community as well as a sound understanding of its needs, which they go all out to fulfil. Thus, small banks' services often have a 'local flavour' which is missing in the standardized offerings of bigger institutions.

While this might turn against them should they venture outside their core market, within it, it has earned them the loyalty and faith of their audience. That's a big plus at a time when others are struggling through a crisis of confidence.

Staying power: Small banks have proven survival skills. Although some institutions were acquired or liquidated during the crisis, most small banks have survived thanks to a combination of agility, restraint and internal control. Hence, their long history is not a matter of good fortune or coincidence, but the result of a clear long term strategy.

Superior service: Their manageable size allows small banks to accommodate local variations based on need or custom. Hence, they are not bound like the behemoths are to offer the same services, channels or experience to all customers. Within the law, small banks are open to 'bending the rules' for certain customers, which gives them a crucial edge in service. Hence, in-branch service is friendly and laidback in a pensioners' town, but turns brisk and professional in the city. These are important lessons for mainstream banks which are now trying to personalize their offerings to the taste of individual users.

Low costs: Small banks have lower funding and operating cost thanks to their limited suite of products, large retail deposit base and modest infrastructure and salaries. This is both a source of resilience and competitive advantage.

Relevant products: At global institutions, the goal of centralized product development is to introduce standardized offerings in every market that they operate in, perhaps with minor variations. Hence, a designer in Europe who creates products to be consumed in Asia, South America and everywhere in between, might base his decisions on the needs of his own market, a set of standard benchmarks or some other consideration. In contrast, because their creator is located so close to the actual users, the products of small banks are designed from the latter's perspective and are usually 'practical' and well-aligned to their preferences. This is one more example of how the ability to make an exception to suit a specific requirement stands small banks in good stead, a point that is elaborated in a later section.

Deep roots: Small banks also demonstrate how deep-rooted they are within the community through their policy of hiring mostly local talent. Employee loyalty and empathy is stronger in these banks as the personnel identify themselves strongly with the brand.

Greater flexibility: These banks are more flexible than the big institutions in many aspects – when charging a fee, extending an overdraft or asking for documentation, for example. Branch managers and tellers are willing to go that extra mile to provide leeway to their customers in sever always. In many institutions, branch managers enjoy higher power and decision making authority which enables them to act fast in their customers' favour.

Small banks have been quite innovative, in their own way.

Amidst all the fanfare surrounding the innovations from leading banks, the small ones have gone about theirs quietly, in the following ways:

Most innovation by small banks is customer-centric. The interest of their customers is the top priority of small banks' innovation agenda; all other considerations are secondary. For instance, some of the branches located in commercial areas collect cash outside of business hours from their customers' business premises, something no big bank would do for fear of the risk involved. Another example is that of First National Bank of Omaha which pioneered the coffee house branch, providing a space within its premises where customers could unwind or check email over a cup of coffee, a concept which was subsequently implemented even by the larger institutions.

Product innovation is much more personalized. There are known examples of how local banks have enhanced a simple savings account by bundling it with a term deposit to help salary earners save more, or linked it to a pension product to offer security to seniors during their twilight years. Some have innovated on term deposits by introducing a step up option to allow customers to add gradually to the account, in contrast to the term deposits of other banks which are not this flexible.

Their channels deliver small innovative services. Like their larger brethren, small banks too have used channel innovation to improve operating efficiency, reach, service and customer experience. Many sport kiosks and online channels offering products and services to meet the expectations of tech-savvy clients. Yet, some, like Umpqua Bank have done a little bit more. They offer a unique cheque printing facility at their kiosks specifically for customers who don't normally use cheques, but might have a one-off requirement.

Small banks are also leveraging the popularity of the mobile phone to improve reach and interaction with customers in regular markets, and acquire new ones among the financially excluded. Some banks in Brazil and Mexico on-board customers purely on the basis of mobile ownership, treating the currency in the mobile phone as an account balance, whereas others in the Middle East are providing their customers a platform for making remittances via mobile.

Although technology may or may not have played a role in the service and product innovation of small banks, it has been the prime mover of their channel innovation efforts. To their credit, technology vendors have taken due note of small banks' constraints – limited financial resources, low risk appetite, small scale of operations – to develop pre-configured core banking solutions which can be implemented quickly, at lower cost, to start them on the road to innovation.

Their innovation is driven by necessity. Often, small banks are forced to innovate in order to ensure business continuity and sustainability. For instance, when they were pressed to reduce their dependence on servicing multiple large borrowings, they shifted towards securitized products. Similarly, small banks operating under stringent regulatory jurisdictions went about compliance smartly, trying to take full advantage of the rules that were enforced upon them by creating a culture of quality which was a catalyst for the drastic improvement of their processes. Building societies in the U.K. for instance, have wholeheartedly adopted the various legislations applicable to their lending business to formalize, clean-up and streamline their processes. This has resulted in increased market confidence,

improved customer satisfaction and employee empowerment.

The future of small banking innovation

Exciting possibilities for innovation await the small banking sector. Which is just as well, because being constrained from expanding their network, these institutions can only grow their business with better products and services, higher cross-sales or other innovative means. One way to get around their size and resource limitations is to pool what they have with other institutions, to mutual benefit. This could take the shape of a co-opetition arrangement in which a small bank throws open its distribution network to a national player, and gets access to the latter's products or technology in return.

In fact, some small banks have been market leaders in the adoption of technology-driven innovation, setting an example to their peers and mainstream competitors by readily embracing the Cloud and hosting services for their hardware requirements. This has given them the singular advantage of converting capital expenditure on IT infrastructure into a variable operating expense.

There's also a real likelihood of identification technologies such as biometrics being used at ATMs to cut short transaction time as well as enable the less literate to adopt the channel. Such technologies come cheap, are pretty

efficient and from the institutions' point of view, also strengthen security against fraud and improve compliance. Cost permitting, video banking might be increasingly deployed to deliver a personal, branch-like experience over self-service channels. And social media might play a key role in the future when these banks need to pursue Gen Y customers.

Because there are so many possibilities open to small banks around the world, there's no telling which path they will take. However, one thing is certain – they're all headed in the direction of innovation.

References

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