From follower to leader

Innovation strategies in retail financial services

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Following: A common path

ING Direct, a branchless Internet bank, entered the United States in 2000—years after the direct banking model was pioneered in that market. In fact, direct banking had already taken broad hold in the industry; even traditional banks were offering online banking services. But despite this late entry, ING Direct became the 21st largest bank, the 10th largest direct mortgage originator, the No. 3 savings bank, and the No. 1 Internet bank in the United States in just eight years.[1]

ING Direct is just one example of a follower who grew to become a market leader. Achieving market leadership years after a pioneer has created the market may seem daunting, but it can be done. The key question, of course, is how.

By definition, there can only be one pioneer in any one product category. In retail financial services, an industry with fairly established product categories, a majority of firms will find themselves in a position similar to that of ING Direct, a follower that is forced to compete with the pioneer as well as other followers.

Business literature is rife with advice on how companies can innovate to become pioneers. The implicit assumption in offering such advice is that the order of entry is a choice—but in reality, most firms act as followers, because completely new product categories are relatively rare. However, despite the fact that followers comprise the vast majority of firms, very little guidance is available on how *followers* should approach innovation in their quest to overtake pioneers. What guidance does exist rarely focuses on the financial services industry.

We sought to fill this gap with research that addresses two key questions that followers in financial services face:

1. **What can followers do to achieve market leadership?** When we examined cases of financial services followers that overtook pioneers, we found that they focused on making their product or service better than the pioneer rather than (or before) making it cheaper. They did so by adding more non-price value, such as greater functionality or better customer service.

2. **How can they do this?** We found that successful financial services followers created more non-price value than competitors by offering a unique mix of innovations across many of the companies' attributes.

TERMS AND DEFINITIONS

The following terms and definitions are used throughout this paper:

Pioneer/first mover: The first firm to enter a new product market

Follower(s): All firms that enter the market after a pioneer

Successful follower: A follower that has gained dominant market share, becoming the market leader in a product category

Innovators: Any firm—regardless of its order of entry—that breaks existing performance trade-offs through a combination of activities or technologies[2]

While there is no definitive research on the topic of successful followers, several recent works offer insights into the phenomenon. Specifically, the non-price value aspect of *The Three Rules*, an analysis of exceptional long-term performance, and *The Ten Types of Innovation*, a framework for identifying and implementing successful innovations, offer a valuable lens through which to consider followers.

Neither framework has previously been used to examine order of entry (followers versus pioneers). However, our analysis found that, used together, these two models shed new light on how followers can emerge to become market leaders.

We present our findings through two cases: ING Direct's direct banking practice and Bank of America's pursuit of credit cards with the BankAmericard.

What we know about pioneers and followers

ORDER of market entry has been a topic of intense interest among both business strategists and scholars for some time now. No one denies that the order of entry matters, but opinions diverge on the question of who has the long-term economic advantage—is it the pioneer or the followers?

In spite of the extensive research on this topic, there appears to be no conclusive answer.

In support of pioneers

A number of studies have contended that pioneers enjoy certain advantages, while followers face market share penalties.[3] Research suggests that pioneers are able to erect certain entry barriers through proprietary technology, patents, or preemption of scarce resources.[4] Further research found that pioneers enjoy greater buyer loyalty, especially in consumer goods industries where customer preferences harden easily.[5]

These findings have also been replicated, to some extent, in financial services. Studying pension funds, debit cards, and credit cards in Costa Rica, Luis E. Lopez and Edward B. Roberts concluded that early entrants do have an advantage in gaining long-term market share.[6]

In support of followers

However, support for pioneer advantages is countered by other research that suggests they face greater costs than followers. For instance, there may be certain disadvantages to being first: higher development costs, shifts in technology and customer preferences, and "free-rider" effects where followers learn from the lessons of pioneers.[7] First-movers have a greater failure rate, and as a result, only a minority of them remains market leaders for long.[8]

Management scholars Fernando Suarez and Gianvito Lanzolla summarized that "for every academic study proving that the first-mover advantage exists, there is a study proving they do not."[9] Much depends on the context and the conditions under which pioneering or following is undertaken.[10]

What did successful followers do?

WHEN a company finds itself in the follower position, it faces key strategic questions on what to do: Should it offer a cheaper product with perhaps fewer features? Or should it innovate further and offer a product with improved or additional benefits?

For many firms, these questions are basically a choice between going "better" or going "cheaper." Both seem like valid approaches, but our analyses of historical financial services cases suggests that one path provided competitive advantages that propelled the follower beyond the pioneer.

Follower to leader: Direct banking

Consider the development of direct banking that was highlighted at the beginning of this paper. The Office of Thrift Supervision approved the first Internet-only bank charter in 1995.[11] Over the following years, the concept of direct banking grew with the emergence of other competitors and the introduction of online services from traditional banks.[12] Despite offering many services comparable to those of a traditional bank, early direct banks struggled to convince the mass market to adopt the new branchless model.

Launched in the United States in 2000, ING Direct knew it had neither the advantage of being first-to-market nor an existing retail banking brand to leverage in the United States, so it bet its success on creating products that offered more value to customers.[13]

To put customers at ease and spur adoption, ING Direct featured easier-to-use interfaces than those offered by competitors, helping ensure customers were comfortable with online banking. ING Direct ran a low-cost operating model by using technology to drive efficiencies through the online channel and eliminating activities with high overhead costs, like paper checks. The bank used this cost savings to pay higher interest rates on savings products, which attracted many customers.[14]

A broad marketing campaign highlighted the simplicity and benefits of ING Direct's products, helping it quickly gain traction. This strategy paid off; in the first six months, ING Direct opened 100,000 accounts and gathered $1 billion in deposits.[15]

ING Direct continued refining its products and developing new ways to deliver value beyond its competitors' offerings. For instance, it launched a network of nontraditional offices known as ING Direct Cafes that provided employee interaction, assistance, and consultation if needed, but it did not replicate a traditional bank branch.

By 2009, ING Direct went from being a little-known institution to becoming a major player in consumer finance as the No. 1 Internet bank in the United States.[16]

THE THREE RULES: HOW EXCEPTIONAL COMPANIES THINK

Why do some companies achieve exceptional performance over the long run while many struggle to survive? To answer this question, Deloitte embarked on a statistical analysis of the performance of 25,000 companies over a 45-year period (1966–2010). From this universe, 344 exceptional companies were identified. Of these, 174 were labeled as **Miracle Workers**, "the best of the best," and 170 were categorized as **Long Runners**, those who were still exceptional but demonstrated performance at a lower level. Miracle Workers competed solely on non-price, value-based positions, while Long Runners used a mix of price and non-price strategies. Then there were the **Average Joes** that were only modestly successful and tended to compete mainly on price.

The most successful companies tend to follow three fundamental rules:

- ***Better before cheaper:*** Build non-price value rather than create a low cost solution.
- ***Revenue before cost:*** Increase revenues rather than reduce costs.
- ***There are no other rules:*** Change anything and everything in order to abide by the first two rules.

The Three Rules does not explicitly consider order of entry, but in analyzing cases in financial services, we found clear evidence that "better before cheaper" helped explain what followers did to become market leaders. Due to a lack of relevant historical data, particularly on internal costs, we did not analyze the second rule, "revenue before cost"; whether followers that become market leaders focus on building revenue over cutting costs remains an open research question.

Better before cheaper

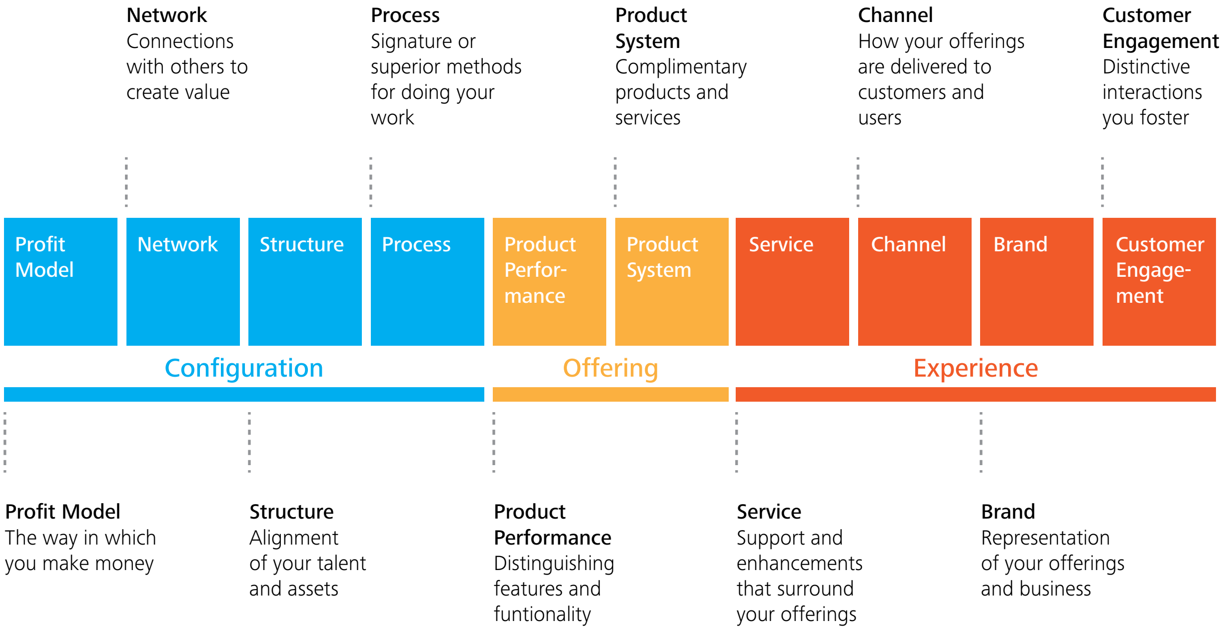
Companies can differentiate themselves on two dimensions of value: price value and non-price value. ING Direct opted to compete by adding more non-price value through improved ease-of-use, brand formation, and customer service. Followers who chose to make their products better by adding non-price value emerged as the market leaders, while followers that chose to compete on price alone, positioning themselves as cheaper alternatives, did not realize the same level of success. This finding is consistent with the idea that companies that focus on creating better non-price value rather than cheaper products achieve more enduring and improved performance.[17] That is to say, successful companies do not ignore price competition, but they do not view price as their primary marketplace advantage either.[18]

How did followers create more non-price value?

GIVEN that "better before cheaper" was an essential factor in ING Direct's success, we are left with another important question: How exactly does a follower create more non-price value? The example of ING, among others, suggests that achieving *better before cheaper* rests on innovating across a spectrum of dimensions. In other words, successful followers understood that to become a market leader they should differentiate not only their product but also their customer experience, business model, and processes to deliver value to customers.

One way to understand the different types of innovation is through the framework described in *The Ten Types of Innovation*, which states that "all great innovations . . . comprise some combination of 10 basic types organized within three categories" (see figure 1).[19]

Figure 1. The Ten Types of Innovation®



Source: *The Ten Types of Innovation* [Doblin]
Graphic: Deloitte University Press | DUPress.com

The three categories of innovation include:
Configuration innovations: These types of innovations are focused on the innermost workings of an enterprise, including its profit model, structure, and processes.

Offering innovations: These types of innovations are focused on an enterprise's core product or service, including its features, complementary products, and distinguishing functionality.

Experience innovations: These types of innovations are focused on the customer-facing elements of an enterprise, including its brand, support, service, and customer engagement.

Mixing innovations from these three categories can create significant competitive advantages and possibly achieve greater long-term success. ING Direct, for instance, used the strategy of mixing a large breadth of innovations to create non-price value (see figure 2). It deployed an "offering" innovation to improve its website's ease-of-use and features beyond competitors, a "configuration" innovation to offer more competitive savings rates, and an "experience" innovation with ING Direct Cafes to provide differentiated customer service.

Figure 2. How followers innovated along *The Ten Types of Innovation*

	Follower	Offering innovation	Configuration innovation	Experience innovation
Retail bank *Direct banking*	**ING Direct**	**Product Performance:** Offered superior ease of use, basic products, high paying savings accounts	**Profit Model:** Paid higher interest rates on savings accounts by eliminating products with costly overhead, like paper checks	**Customer Engagement:** Opened ING Direct Cafes to build brand awareness
Payments *Credit card*	**BankAmericard**	**Product Performance:** Offered revolving credit to expand spending capacity	**Network:** Created alliances to expand card distribution	**Customer Engagement:** Provided unsolicited cards to promote usage **Brand:** Consolidated various cards in different geographies to leverage benefits of a common, widely accepted brand

Creating value through a mix of innovations

BANKAMERICARD offers another example of a company that created non-price value through a mix of innovations. Early payment cards, launched in the 1950s, were meant for affluent customers and designed for entertainment and travel expenses.[20] Although the early cards were popular among its customers, many firms struggled to achieve broad distribution for many reasons.[21] But Bank of America launched BankAmericard in 1958, using a mix of innovations to become the new market leader.

Offering innovation: Revolving credit

Existing cards were "charge cards," which had to be paid in full at the end of each month.[22] BankAmericard sought to differentiate itself with an "offering" innovation by introducing general-purpose credit cards with revolving credit.[23] Although this feature meant additional costs to consumers in interest on their balances, the card offered important non-price value through greater spending capacity.

Configuration innovation: Distribution network

When BankAmericard was launched, there were strict laws restricting banks' ability to operate across state lines. As a result, customers were unable to use their cards across certain geographic boundaries, and banks were unable to attract customers outside of their home states.[24]

To overcome this challenge, Bank of America broke from the prevailing operating model of issuing one's own cards. Bank of America took a new approach by entering into licensing agreements with banks in other states to issue the cards, while it retained the infrastructure to facilitate transactions.

The broad network of banks that issued BankAmericard, a "configuration" innovation, significantly increased the customers it could reach and the merchants that could accept the card.[25]

Experience innovation: New marketing approach and brand consolidation

Finally, BankAmericard promoted adoption and brand awareness with a bold marketing strategy of mailing unsolicited credit cards to consumers drawn from a mass-mailing list.[26] These were not applications for cards; they were live cards.

While controversial and subject to regulatory action later on, this marketing approach helped create strong product awareness.[27] This "experience" innovation further distinguished the brand from its competitors.

BankAmericard also solidified its brand equity by consolidating the different brands across countries and rebranding itself as Visa in 1976.[28]

As a result of its emphasis on non-price value through a mix of innovations, BankAmericard grew in popularity and usage; by 1985, the card had gathered 43 percent of payment card volume—well ahead of other competitors.[29] Bank of America's success in creating more non-price value was a result of combining a broad mix of innovations instead of concentrating innovation efforts on one aspect of the product.

Follower to leader

IN retail financial services, a sector that has historically had fairly established product categories, few firms have been pioneers. Most have competed as followers. And as non-banks and technology firms increasingly offer innovations for the retail financial services market, follower strategies will become even more important.

History offers examples of followers emerging as market leaders, demonstrating that it can be done. Followers became market leaders by creating greater non-price value than their competitors by using a broad mix of innovations.

These firms focused on offering better rather than cheaper alternatives than the pioneer, and they avoided concentrating innovation efforts on a limited set of features.

Offering greater non-price value will require firm leadership to remain acutely aware of how their offerings compare to their competitors, what skills and capabilities need to be developed, and where the firm is uniquely suited to innovate.

Furthermore, as success lies in bringing together many innovations across the organization, management should align culture, processes, and incentives to enable collaboration.

Using the insights from our findings, firms in retail financial services can more effectively design their innovation strategies, and have greater certainty in their path from follower to leader.

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