Innovation strategies and the problems of their implementation by the Ukrainian banks

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1. Introduction

Innovation is one of the main engines of long-term economic growth and structural change and has always driven economic progress. In recent decades, the development of the banking sector, which was notable for certain conservatism and immutability until now, has assumed an innovative character. Under conditions of volatile external environment and escalating competition banks are increasingly turning to new, innovative sources of growth, but a large-scale positive impact can be expected only under a strategic approach to innovation process management.

This proposition is valid both for banks in advanced countries and for financial institutions of transition economies including Ukraine. And the last ones face much more complex problems because the strategic management system itself is here in the making. Therefore, it is actual to outline the basic theoretical foundations of banking strategic innovation management and to analyze the real practice of innovative banking strategies formation and implementation.

The article proceeds as follows. Section two offers a frame of theoretical framework for the analysis of banking innovation strategies. The attributes of these strategies generated by the modern economic development are outlined in section three. Section four discloses the types of innovation strategies executed by the Ukrainian commercial banks. The final section is devoted to the problems of innovation strategies implementation in the banking system of Ukraine.

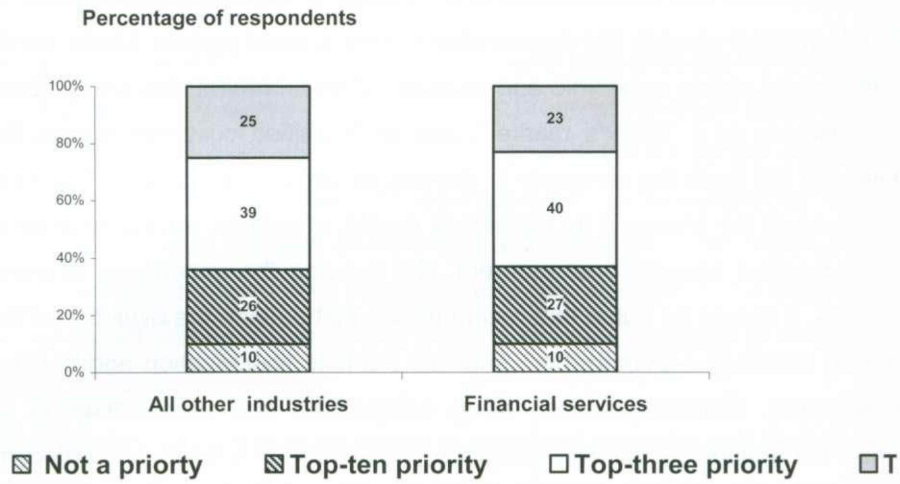
2. Banking strategic innovation management

As it is known, strategic management means the aggregate of managerial decisions and actions which determine long-term perspectives and company economic performance. It consists of external and internal environment analysis, strategy formulation, implementation, evaluation and control.

The importance and effectiveness of a strategy is determined, above all, by the role which it plays in the organization's management system. Under conditions of quite stable economic and institutional environment, low competition, the existence of a "seller's market", and undiversified customer needs, the banks did not have the necessity to develop an innovative strategy. Business growth could be provided by increasing scales of activity, saving resources, and competent financial management. Not denying the importance of these methods, it should be noted that recent trends that defined the evolution of the banking business - globalization, financial markets liberalization and banking deregulation, disintermediation, rising competition and modification of its forms, information technology progress, "retailization" - have created completely new conditions for financial institutions activity, where their innovativeness became an indispensable component of sustainable development.

It is necessary to state that the banks began to innovate much later than the industrial enterprises, and the desire to avoid regulation or to earn on imperfection of the financial markets [12] was for a long time a greater incentive for innovation than their perception by top-management as a development factor. Therefore, innovation process was not considered in the corporate strategy build-up and did not have systematic character. That might be explained by the complexity of protecting financial innovations as intellectual property objects, the absence of R&D departments, the banks inherent desire to reduce risks, the idea about banking conservatism formed in the public consciousness etc.

However, nowadays, in spite of serious impacts, caused to the national banking systems by the global financial crisis, the number of financial institutions that consider innovation as a strategic priority is almost equal to the same indices relating to organizations from the other economic areas (fig. 1) [2].



igure 1. Innovation as a strategic priority

wever it is necessary to take into account the results of the study conducted 2009 by EFMA-Infosys which states that only one third of 89 banks, representing different regions of Europe, think that they do have innovative strateis (Fig. 2). Moreover, according to the authors of the report, if respondents re guided by a rigorous definition of what constitutes an innovation strategy ncluding for example objectives, processes and measures of success – the oportion would be lower [10].

, due to certain objective circumstances, the concept of strategic banking iovation management is still being forming. This corresponds to the theory consecutive stages of organizations management development in a volatile vironment [9]. It begins as usual financial planning (i.e. the determining of effectiveness and feasibility of some innovation projects) and then transms into the forecast planning (i.e. the highlighting of innovation specific ars according to market researches), externally oriented planning (i.e. carrying t innovation activity as a response to the changing markets) and, finally, to ategic management, when innovation implementation issues become a part corporate and business strategies, without which the achievement of overall ategic goals and bank mission are absolutely impossible.

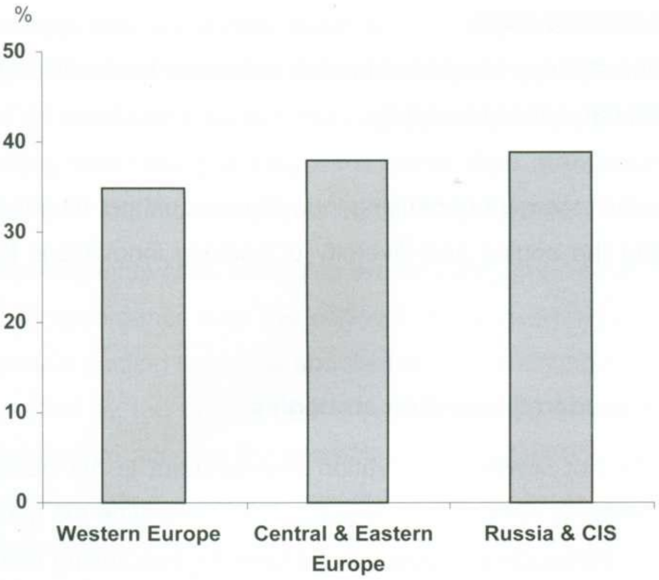


Figure 2. Proportion of banks with an innovation strategy

As banking implies offering financial services, banking strategic innovatio management theory should take into account the peculiarities of the innovatio process in services as a specific sector of economy [13]. These peculiaritie result from the intangible nature of the products, closer contacts with consum- ers, a somewhat ad hoc process of innovative ideas emergence that are no R&D results, a greater role of organization self-learning, a tendency to the open innovation networks formation, etc.

In our point of view innovative banking strategies formation needs to meet the following commonly accepted content requirements [1]:

- sequence - a strategy should not contain conflicting objectives anc programs;
- consistency - a strategy should incorporate adaptive responses to ex- ternal environment changes;

- benefits provision - supporting and strengthening the competitive advantages in selected areas;
- feasibility - the strategy should not involve excessive costs and lead to problems that can not be resolved.

Finally, the strategic management of banking innovation would not be effective without understanding the origins and diversity of banking innovations [6, 7, 14].

3. Attributes of modern innovation strategies

Thus, the main content of strategic innovation management is the development and implementation of innovative strategies. They determine the general policies of the bank in introducing innovation of different types, taking into account the existing resources and organizational capabilities, in order to achieve strategic corporate objectives, increase the economic value for consumers, and provide banking flexibility and responsiveness.

In strategic innovation management it's necessary to take into account that sustainable and dynamic bank development presupposes balancing the interests of banks as commercial organizations, their clients and the society as a whole. Financial institutions can only provide their own welfare if they favour national economy stable development by meeting customers' needs. The functional role of the banks as financial intermediaries is manifested in a range of various services they provide.

Modern economy development trends and the emergence of new theoretical concepts of innovation undoubtedly influence the nature and content of banks innovative strategies. For instance, the development of information and communication technologies, using the Internet worldwide, and overall improvements in the banking manufacturability has resulted in a gradual transition from product innovations as a predominant type of bank innovative activity to the process ones. According to their nature, process innovations are designed to improve the conditions and mechanisms of the banks fulfillment of their fundamental role in a society that is to meet the needs of economic agents in a variety of financial services. Thus, banking innovative strategies are now directed at developing perfect technologies, high-tech service processes, and optimizing intra-business processes rather than at introducing new products and services that are easily imitated by the competitors.

The banking innovative strategies are currently becoming more socially orientated. In accordance with the concept of corporate social responsibility, any company in settling the issue about what, how and for whom to produce, is not only guided by the criteria of the market expediency and profitability, but is also taking into account the interests of the parties. Creating socially-oriented innovations opens a unique opportunity for banks to market positioning and positively affects their image.

In our opinion, the main areas of corporate social responsibility doctrine integration into strategic innovation banking management are:

- promotion of environmental protection (innovative lending and investment products, introduction of paperless, energy-saving technologies);
- active participation in the life of local communities (creating financial products to meet the local needs, develop small business, and establish effective social communications, combining common functions of bank branches with the ones of regional communities social life centers);
- involvement of underbanked people, low-income people, immigrants, residents of rural and remote districts, etc. in using modern financial services;
- formation of children and teenagers financial competence and culture;

- implementation of Islamic banking concept, taking into account the growing stratum of the Muslim population in most countries. This concept is based on absolutely different principles compared to usual banking, nevertheless it permits banks to receive stable income and is much less risky.
- Nowadays the concept of open innovation has an increasing influence on the implementation of banks' innovative strategies. It was suggested in 2003 by H. Chesbrough [4] and has been further developed relative to the banking sector [5]. According to H. Chesbrough, "open innovation is a paradigm that assumes that firms can and should use external ideas as well as internal ideas, and internal and external paths to market, as they look to advance their technology. Open innovation processes combine internal and external ideas into architectures and systems" [8]. The old model of innovation activity, which included the implementation of all phases of the innovation process inside the company, can no longer be effective in today's environment of shared knowledge and network technologies.

Regarding banks, this means that they should more actively use the opportunities of strategic partnerships and alliances to conduct joint researches, attract external developers, including specialized online platforms, and use innovative products and technologies offered by information and telecommunication companies. Banks should neither also neglect the learning and modification of the experience from other businesses, and cooperation with research institutions. Within the open innovation concept customers are considered as partners, so they are included in the mechanism of generating and testing innovative ideas.

In banking it is also possible to use such a strategy of innovation changes as value innovation [3]. In this case the companies do not try to overtake and surpass competitors, but make efforts to create a new market, a new absolute consumer value for the buyer, thereby practically knocking out opponents.

Therefore, value innovators abstract from the current business conditions, competitive environment, and common strategies and offer to put a client, not a competition victory, in the center of strategic thinking.

A significant example of this concept realization in banking was the creation of a completely new Internet services market in the mid-1990's, which emerged at the intersection of the results of revolutionary development of information technology and banks' efforts to create additional value for customers and significantly reduce their own costs.

4. Ukrainian banks' innovation strategies

The complicated process of formation and development of banking systems in transition economies has also affected the establishment of strategic management in the Ukrainian commercial banks. During the 1990's banks mastered the basic techniques and forms of work, built the appropriate organizational structures, formed human resources, and assimilated the operations, which at that time were already commonly used in foreign banks practices. Under a sharp decline in output, hyperinflation, economy "barterization", and finally - a deep financial crisis (1998), banks had to solve tactical problems to ensure capital adequacy, liquidity and profitability. It is significant that only since the mid 1990's, most banks began to establish marketing departments.

So attention to bank strategic management was paid only with the gradual stabilization of the economic situation in Ukraine since the early 2000's. It should be noted that as in the advanced countries the relatively reliable strategic bank development forecast can be made for a period of three to seven years. For the transition economies this term is much shorter (up to three years). Exactly this strategic planning term has been provided by the National Bank of Ukraine regulations for the banks which are to be created.

As for the strategic approach to innovation, it is just being formed in Ukrainian banks. It is considered that innovation management is strategically performed if it:

- is conducted at the top-management level of the bank;
- relates to a long term and aims to achieve bank mission and strategic goals;
- flexibly responds to external environmental changes;
- regards human resources as the base of bank innovative development.

On 01.12.2009 the Ukrainian banking system consisted of 185 operating commercial banks. 32 banks were partly and 18 fully owned by foreign capital, so the share of foreign capital in the authorized capital of the Ukrainian banks accounted for 33.7%.

The capital of the Ukrainian banking system amounted to 119.8 billion hryvnias (about 10.0 billion euro), accounting for about 10% of GDP. Capital adequacy ratio was 18.28%. Net assets amounted to 879.2 billion hryvnias (73.3 billion euro), and 85% of them were generated by loans. The share of problem loans accounted for 8.7% of the loan portfolio. Investments in securities amounted to 4% of the bank assets.

Bank liabilities were formed at the expense of entities to 14.7%, at the expense of individuals - to 27.1% and at the expense of debt securities - to only 1%. The financial result of 27.6 billion hryvnias (2.3 billion euro) negative profit was formed owing to accelerated formation of the banks provisions for loan losses.

Until recently, the innovation process in the financial institutions has not been systematic. According to the opinion of experts it has had spontaneous nature [15]. Nowadays, Ukrainian banks actually use not formal, but intuitive innovative strategies related to the changes in the product lines, the forming of new activity areas, and to technological and organizational transformations.

It should be noted that a visible innovation activity is characteristic of only a certain segment of the banking system of Ukraine. It includes, firstly, the banks that have national capital and by the classification of the NBU are among the largest and large ones (Privatbank, Ukreximbank, First Ukrainian International Bank, Brokbiznesbank, Bank Khreshchatyk, etc.); secondly, foreign capital banks and subsidiaries of foreign banks (Raiffeisen Bank Aval, Ukrsibbank, Ukrsotsbank, OTP Bank, Alfa Bank, Swedbank, Pravexbank, ProCredit Bank, etc.), as well as some newly established banks, which are notable for their aggressive strategy and specific business models (Delta Bank, International Mortgage Bank). Small regional banks yet do not try to build competitive position and key competencies through innovations, as it takes place, for instance, in the United States.

Analysis of the empirical data on innovation activities of the Ukrainian banks received from periodicals, news websites and financial institutions sites resulted in identifying some regularities that formed the innovative strategies content of the leading banks in Ukraine.

One can observe a focus on the introduction of innovations, which are new only for the national market, as well as for a certain banking institution (due to their diffusion). Very often the role of this strategy "champions" is played by the parent companies of Ukrainian foreign capital banks. For example, we can mention the emergence of new activity areas of the Ukrainian banks - private banking, bankinsurance, bank investment funds, organizational and technological branches rearrangement, CRM-systems implementation, etc.

However, in the field of technology some banks, primarily PrivatBank, seek to develop unique products. That resulted, for instance, in the creation of the world's first bank Internet-widget in 2008, i.e. a program providing the simplest banking services that anyone can install on one's own website or social network profile.

As for the introduction of innovations with different degree of radicalism, we can say that innovative strategies of the leading banks in Ukraine are various combinations of radical and incremental innovation projects, depending on the capabilities and organizational abilities of a particular financial institution. As a rule, incremental innovations were associated with the improvements in current and deposit accounts, mass loan products etc. Radical innovations were implemented particularly in corporate banking: cash management (Alfa-Bank (Ukraine), OTP Bank, Raiffeisen Bank Aval, Ukrsibbank), factoring and international factoring (Ukrsotsbank, Swedbank), trade finance (Ukreximbank, Bank Nadra, Ukrsotsbank), project finance (Ukrsibbank, Ukreximbank, PrivatBank), microcredits for small and medium-sized enterprises (ProCredit Bank, PrivatBank) etc.

Banks' practices show that strategically managed incremental innovation stream, forming necessary experience, creates an innovation culture and technological standards giving grounds for the forthcoming radical innovations. The particularity of the Ukrainian banks' innovative strategies, just like the ones from the other post-Soviet countries, is the fact that they, as a rule, are aimed at forming new consumer needs, rather than meeting the market demands. That might be explained by poor financial culture of citizens and entrepreneurs, historically not developed various banking services requirements, non-perception of bank as financial advisors and consultants. Therefore, in order to benefit from innovation the Ukrainian banks need to perform much advisory, explanatory, educational work among all their customers' segments.

Concerning their content the commercial banks' innovative strategies have become much more diversified. Originally there were only product, technological and, in some way, managerial and organizational strategies, and now we can speak about service (customer service business processes improvement, modification of employees' roles and positions), marketing (sales channels differentiation, brand and marketing communications development) and even about business model innovative strategies (focusing on core competencies, outsourcing, etc.).

5. Innovation strategies implementation problems.

As it was previously noted, innovative strategies formation and implementation was a challenge even for the banks in advanced countries, not to mention the financial institutions in emerging markets, characterized by the lack of experience in innovation and strategic planning. Non-systematic innovation in most Ukrainian banks doesn't create favourable conditions for its transforming into a formal business process that should be the subject of strategic management.

Foreign banks' practices show that a very important factor of innovative strategies quality formulation and effective implementation is the creation of a special culture of innovation that would encourage bank staff to generate new ideas and to introduce them in all spheres of banking. Innovation culture components are: the creativity of employees, their commitment to the constant change process, consent to take reasonable risks, and bank management's understanding the possibility of failures and their constructive perception. Innovative culture is not formed by itself and should be deliberately and consistently created by the bank's management, and today even the leading Ukrainian banks are only at the first stages of this process. Inertia and conservatism of the banking staff are being gradually overcome by continuous learning and training, initiating of "brainstorming", building innovators' financial and nonfinancial incentive systems.

According to the authors of BSC concept D. Norton and R. Kaplan, a major cause of companies' failures is not actually a bad strategy but a poor system of its implementation [11]. The following factors hamper the possibility of Ukrainian banks to use innovation as a strategic growth factor: the absence of departments that would coordinate innovation activities, the absence of innovation development and implementation processes technological maps, the lack of innovation management professionals, including top-level ones. The mechanism for collection and selection of innovative ideas and the creation of innovation portfolio on this basis is undeveloped. As usual, the innovation initiatives, if they exist at all, come only from the top management. Traditional functional and informational isolation of banking departments hinder the development of effective innovative communications.

An important problem is the lack of methods for measuring bank innovation activities, in general, and the effectiveness of innovative strategies implementation, in particular. It doesn't permit to critically assess the results achieved, to compare them with the previous ones and with the targets, to reward top employees. This problem has not been solved yet in theory. To our mind, the future research guidelines consist in the adaptation of the well-known Balanced Scorecard that includes four dimensions - finances, external customers, internal business processes, staff training and development - to the innovative strategies evaluation.

6. Conclusion

The research presented in the article sought to explore the theoretical framework and the practical realization *of strategic bank innovation management.* We have stressed the lack of investigations related to theoretical aspects of innovative strategies in banking. On the other hand, a large amount of empirical *material, particularly* on banks *in advanced countries, has made it* possible to find out some of their modern specific features: the domination of process innovations, the intensification of strategies social orientation, and the use of open innovation and value innovation concepts.

As for the Ukrainian banks, it was ascertained that their innovation strategies are not formal but intuitive and the whole innovation activity is rather chaotic and unsystematic. We have explored some issues which are now characteristic for these processes: the focus on introduction of innovations, which are only new for the Ukrainian market, orientation towards the formation of new consumer needs, and diversification of innovative strategies from the point of view of their content. At the same time an innovation culture is practically absent and there is a poor system of strategies implementation.

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