

## ADDED VALUE THROUGH INNOVATION

The ability to be innovative is a central resource for companies in order to be able to act successfully over the long-term. Innovation ability means continually integrating knowledge and ideas into new products, processes and systems. An organisational structure which promotes innovation not only supports companies in the early phases of idea generation, but also in the later phases in the implementation and successful marketing.

The following innovation culture concept shows principles of organisational behaviour which have a direct impact on an organisation's ability to innovate. For despite industry and company-specific features, there is much evidence that key elements and processes exist, which contribute to an effective implementation of innovation across the industry.

The innovation culture of an organisation can be seen in the

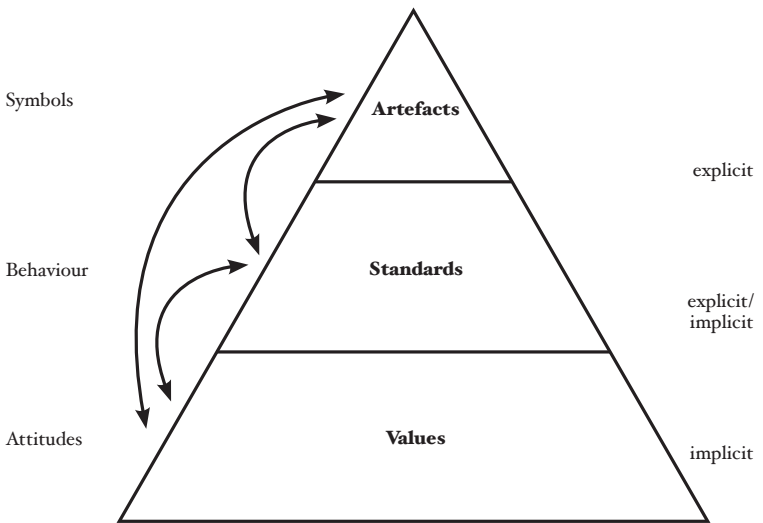
**† Edgar Schein is an emeritus MIT professor and decisive co-founder of Organisational Culture Research. He lives and works in Boston.**

lived standards and routine behaviour. It reflects the value-orientation of the company and is expressed in its incentive system. The innovation culture therefore has a direct impact on the performance of an organisation.

This means that culture based on a largely *implied (i.e. not directly accessible) knowledge basis* develops from past *experience*, which is reproduced using *socialisation processes* and is reflected in the *behaviour* of its employees. It includes abstract *values, attitudes and concrete standards* and, once learnt, *can be influenced by management behaviour*. *Innovation-based* culture can be found in the type and manner of the (*problem-solving*) *behaviour* deemed to be appropriate and in the values and attitudes underlying it. It can be found in the daily behaviour of its employees and impacts on the *innovation ability* of an organisation which contributes to the added value of a company.

The model of culture by EDGAR SCHEIN is an internationally proven basis for a more elastic understanding of the term culture.\*) His model is based on a reciprocal value, i.e. mutually influencing, standard and behaviour relations.

## Knowledge basis



## **Values and basic attitudes**

Generally speaking, the basis of a culture lies in the *values* or general basic assumptions which underlie a cultural community. These basic assumptions are part of the cultural knowledge basis, which is unspoken and not directly observable (implicit). According to the opinion stated here, it includes implicit theories about the existence and functioning of the organisation and convictions about what is seen as good or bad, normal or abnormal, rational or irrational.

## **Standards**

The next level of the model includes the standards (standards, guidelines, prohibitions). These include expectations about what is deemed to be appropriate or inappropriate attitudes or behaviour. Standards simplify group processes, as they rely on the fact that some things are done, and some things are not done. They are mostly aware of the members of a culture. Group standards can vary, however, in respect of the extent of their acceptance, application and rigidity.

## **Artefacts**

The most visible upper level, but also the level requiring most interpretation, refers to so-called “*artefacts*”. Artefacts are directly observable and relate both to the physical elements of an organisation, such as the architecture, equipment and spatial design, company logo, clothing of the employees, and also to explicit behavioural patterns, such as ways of behaving, stories, speaking, jokes, rituals and celebrations.

In order to be innovative, knowledge processing is central. What does this mean in concrete terms? What does a company have to be able to do in principle in order to be permanently successful and innovative? And how can these thinking processes be supported?

This means, what does the relevant practice in the company look like, how do employees solve problems, how do they communicate, how do they deal with conflicts, how great is the daily workload, how much corporate freedom is available, how are errors dealt with? What values are represented and what implied basic assumptions exist?

In view of numerous empirical studies, four central individual, but also linked, interacting cultural dimensions are derived. Together, these form an innovation-promoting organisational culture, and are:

- Corporate freedom
- Communication / cooperation / conflict
- Dealing with errors
- Barriers

The cultural dimensions (and, in particular, their specific behaviours) are relevant during all innovation phases and are interesting for all companies which want to accelerate their innovation process. The phases of an innovation process can now run

from the initiative, through the development of the business, the broad market development or research, to development and series development. The individual cultural components are described in detail below and brought to life and graphically illustrated with practical examples from Capital Bank.

### **Corporate freedom**

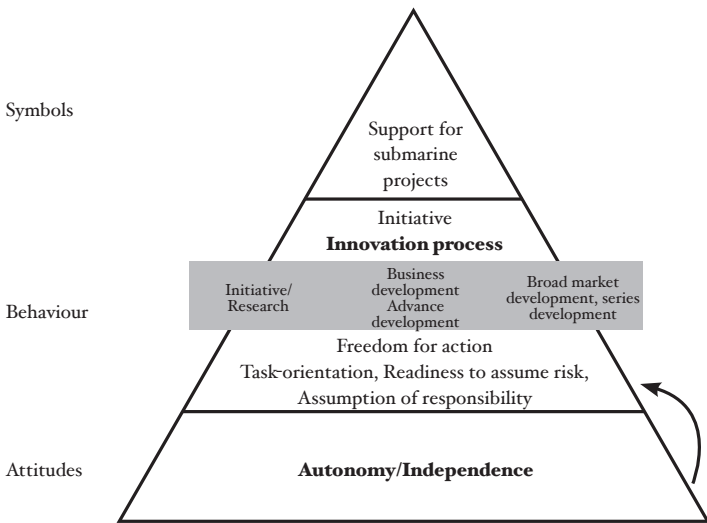
The cultural component *corporate freedom* includes two mutually conditional innovation-promoting aspects: a necessary *corporate* component, based on Schumpeter, with task-orientation and readiness to assume risk, and the aspect of time and activity-based *freedom* (room for action), which is often described above all in creativity literature. If these aspects are in place, it is probable that people in the company will take up and implement initiatives.

The basic attitude for a functioning use of the corporate freedom granted is autonomy/independence. It refers to an active assumption of responsibility which complies with

the corporate goal and which serves completion of tasks in the interests of clients and of the company.

The support for success-relevant but little-known projects can be seen as visible artefacts of this culture dimension. They are frequently described in innovation management as submarine projects.





*In Capital Bank, corporate freedom is one of the most central components of its business model. The corporate independent orientation of the organisation is considerably anchored through the financial independence of the GRAWE Group over the last 183 years, and also thanks to the supported independence of individual advisors. The senior advisors act with autonomous independence. As a result, they are able to take the initiative themselves based on their own experience and can react individually and flexibly to customer desires and/or new general conditions, and can also introduce promising but little-known investment products independently of the market opinion. In October 2006, for example, the previously little-known hedge fund manager John Paulson was discovered, who was betting on the subprime bubble, which was barely discussed in Europe at the time. This fund entered the asset management of the Family Office as the Capital Bank Paulson Credit Opportunities Certificate and was used in the bank itself as a hedge against the consequences of any subprime crisis. Still counter to the standard market opinion at the time, this product proved to be an excellent investment just a few months later, which exceeded the expectations for it around the world. After the first year, the investment had already increased tenfold.*

*However, this example of success for independent freedom of choice is also diametrically opposed by spectacular investment: with the investments in the funds, behind which hid the fraudster Bernard L. Madoff. Our interest was awakened by the long and extraordinarily stable success story of Madoff's management, whereby we first wanted to understand the investment strategy behind it. Despite*

*extraordinary measures, such as the visit to the custodial bank in Luxembourg and constant monitoring of the bank statements provided by it, we could not stop our customers from becoming victims of the largest fraud in financial history: the custodial account statements provided had been falsified, the securities recorded had never been purchased.*

*The world's best hedge fund and the largest case of fraud: two examples of the opportunities and risks of looking for the best investment ideas. Even when we know that there can be no guarantee for error-free investing going forward, we constantly try to learn from these experiences and thus to improve the quality of advice. Customers are free to decide which form of advice and information is desirable from their perspective. It is possible to choose between the two options with constant advice, the advice or asset management contract, or one-off advice upon request (buy and hold), and the no-advice execution account (brokerage). This choice allows the customer to personally tailor to an individual extent the independence and readiness to assume risk while ensuring personal corporate freedom. Open and honest communication between the bank and its clients*

is an important condition here. All product commission is disclosed and as part of the independence guarantee is not retained but credited to the customer.

### **Communication, cooperation, conflict**

The cultural component *communication, cooperation, conflict* comprises three mutually interacting aspects, open and honest communication, benevolent cooperation and the constructive handling of conflicts. Teamwork and informal networks of employees and customers are becoming increasingly important and an active transfer of knowledge between these groups has a critical impact on the implementation of the strategy and ultimately on the organisational success.

Innovative proposals, in particular, frequently spring from upstream, extensive exchange processes with other departments, whereby knowledge is selectively collated and employee information from different sources is combined in new ways. If the possibility to exchange questions and experience is used, advice and support is offered and accepted, and constructive discussions are held to find alternative solutions, different perspectives can contribute to a more creative solution.

*In this context, Capital Bank has built up an independent, international network. Knowledge from these collaborations is constantly checked and adjusted. Investment ideas and products come both from different departments and from the customers into a central certification department, and are subject to a quantitative and qualitative assessment process. The experiences of various different specialists are effectively and efficiently collated and analysed in this way and can then be used in the advice and asset management. Using our internal knowledge database, fast access to all relevant information is guaranteed, thereby operating professional and active knowledge management. The new risk management constantly checks the composition of all customer custodial accounts and, together with the customer advisor acts as an additional internal control and early warning system in order to detect possible losses early and to be able to act.*

*Capital Bank encourages the greatest possible openness of its business model and transparency in respect of its functioning, both internally and externally. As a sign of the seriousness of the matter, an open letter was addresses to all*

*customers in July 2009 explaining the business model in place to this time, along with an official acknowledgement of the errors and a response from the management. Shortly thereafter, also in July 2009, a customer event was held, at which the entire subject was addressed and discussed in an open meeting. Internally we are also trying to create a climate of psychological certainty through respectful and dignifying ways of coping, which also allow difficult matters to be discussed openly and with confidence.*

*In addition, employees are explicitly encouraged to expand their knowledge and to communicate within the company and with customers.*

*By 31.12.2010, each customer was therefore personally informed of the fair-and-honest model devised in the strategy meeting and of the choice of the desired future advice form.*

Due to the increasing density of information, international, interdisciplinary and individual knowledge is combined to successfully create innovations. The more complex and time-critical the development of innovations or, in this case, the evaluation of investment products and strategies, the more important it is for the available resources within a company to be used efficiently and effectively. In this context, the term resources refers to the broad knowledge base available to the employees of a bank or any other company and to its customers. Initiating innovations, and implementing them, requires reflection on existing products and practices, and possible solutions. A constant exchange of information is necessary in order to obtain, consider and integrate helpful information.

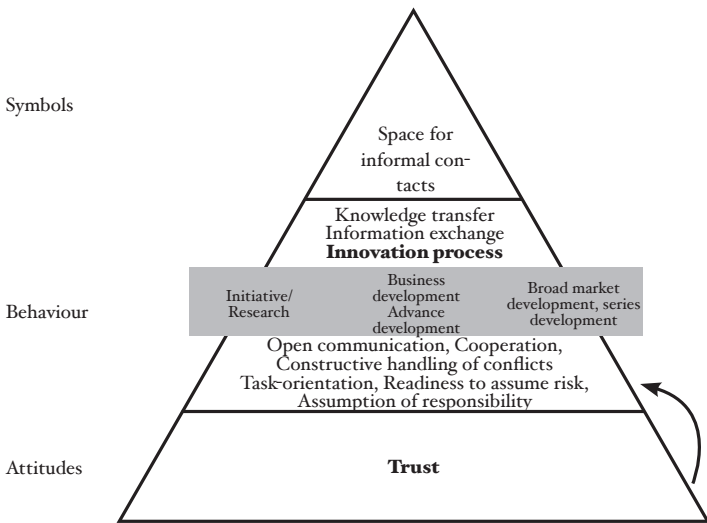
Open communication, cooperation and constructive conflict resolution require trust relationships among the persons involved in the innovation process. Trust comprises (1) belief in respect of the benevolence, integrity and competence of the other party and (2) situation-specific

intention to trust, in order to act in the best possible sense for the common interest.

Various studies prove that trust can be promoted through procedural fairness and psychological certainty in the company. Psychological certainty means a common conviction and understanding that nobody will be compromised, held back or punished when they express their own opinion or concern. It is an environment where team members feel free to express their doubts as well.

Along with space for informal contacts, generally accessible and regularly updated databases facilitate a rapid exchange of information and quick knowledge transfer.





## Dealing with errors

Open and honest communication is also a critical factor for the success of the cultural component *dealing with errors*. Innovations are often characterised by a high level of uncertainty in respect of their feasibility, their market success and their corporate benefit. Especially at the start of an innovation, the extent of possible interactions is not yet known and can remain open in part until very late in the innovation process. This also applies to investments on the financial market. This high level of uncertainty can and must be countered by an attentive attitude towards errors and continual learning.

*Each Capital Bank employee is personally advised by the corporate management that errors are fatal, above all, if they are or remain actively concealed. On their WELCOME DAY, each new employee is confronted with the story of Nick Leeson, a former independent trader who through risky speculations caused the collapse of Barings, one of the oldest investment banks in Great Britain. He concealed his losses and with a supposedly small, easy-to-correct false entry, he brought down England's oldest investment bank.*

*The explicit request to all employees is therefore that errors may occur. But: everyone must report their errors, discuss them and learn from their errors, and they must be communicated openly. And: no error may occur twice. Risk management has a database of all errors which have been*

*noticed by customers (for example in respect of the cancellation rate of bills). The explicit target is an error rate of 0.01 %.*

*Identified errors are part of the knowledge content and experience that are particularly valuable for companies. In the banking sector in particular, (technical) knowledge is incredibly important and critical for corporate success. Our employees are knowledge workers and their acquired knowledge is therefore especially valuable. However, even at the current error rate of 0.1 %, we see the need to improve this in order to achieve our goal of 0.01 %.*

*There are examples from various branches where extensive, costly, reputation-damaging recall actions have been necessary due to small technical defects with devastating effects, which could have been solved relatively easily at an earlier point in time. The errors should have been addressed earlier.*

*An example: Based on a discussion about clothing, we wanted to introduce uniforms and took corresponding measures, recorded individual measurements, etc. Unfortunately, it was found*

*that the quality of the garments designed did not satisfy our requirements so we abandoned the idea. Another idea was to provide music to the telephone banking queue with a tribute to Tina Turner's song "I'm your private banker". This was also a failure, as it did not suit the claims for seriousness and responsibility of our activities. Quintessence: even corporate management is free to try something, test it, and then abandon it if it is not found to be functional.*

Errors can serve as triggers for learning processes and therefore are fundamentally considered an important component of knowledge generation. Learning organisations are characterised by systematic problem-solving, experimenting with new procedures, learning from own experience and own history, as well as learning from the experiences of others and fast transfer of knowledge.

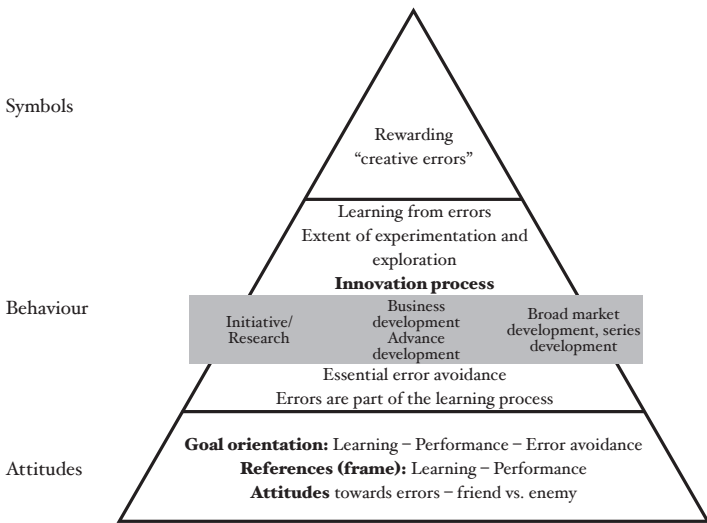
The knowledge necessary for successful innovation implementation can therefore only be generated if an error-conscious culture allows it to report errors made and to expose the associated risks.

In less successful implementation processes, it can be seen that the input from employees is ignored and an analysis of what can be learnt from the experience is carried out much too late, if at all. The constructive handling of mistakes therefore represents an important indicator for the success of the company, in particular in the uncertain environment of innovations.

Even if the cause of errors is looked at from a too narrow angle, the risk that the originally underlying causes will not be found and corrected, is great and results in subsequent errors. If only the symptoms are fought, changes are superficial and short-term. The same errors occur again and again and lead to similar or more serious undesirable consequences.

The recommendation to be drawn from this, for use in practice, is to devote particular attention to the constructive handling of errors. For a strong, error-averse attitude in the sense of a very short-term performance goal can lead to active avoidance and tabooisation of errors. If mistakes and their consequences are not adequately addressed, no new knowledge is gained from them and the probability that similar errors will occur in future increases. Rewarding so-called “creative errors” or an explanation as to why they are creative, can also be a useful instrument for creating an awareness of errors in organisations and for removing the taboo surrounding them and for guaranteeing

a constructive handling of errors. The constructive handling of errors is a central resource for a sustainable corporate management and not only directly relevant to success in banking.



## Barriers

The cultural component *barriers* is an aspect which occurs again and again in the innovation process. Compared to the other three cultural dimensions of *corporate freedom, communication, cooperation, conflict, and dealing with errors*, which should be represented as strongly as possible, the cultural dimension *barriers* should be as small as possible. An innovation barrier is defined as *each aspect with a negative impact on the innovation process*.

*Capital Bank tries to avoid bottlenecks by granting wide-ranging freedoms and through extensive communication. The corporate goals are communicated openly, repeatedly and by multimedia, and passing responsibility is not tolerated. We underline this with our incentive system as well.*

*We would like to offer the service of a 6-star hotel and we endeavour to keep the quality correspondingly high and also to strengthen the individual customer service. Alongside the individual advice models for our customers, we are also interested in creating a pleasant atmosphere. Consequently, we have taken into account aspects of the acoustic and olfactory sensations of our services as well as considering the visually very attractive architecture of our offices and meeting rooms. Everything is an expression of our quality orientation and our goal of attaining the highest standards.*



*In this way, we are trying to keep the barriers in our company as small as possible and to take all supporting measures that allow us to work innovatively, effectively and efficiently.*

Innovation processes are characterised by a large number of barriers. These can have an effect at the individual, corporate, communication and national level and can be divided roughly into internal and external barriers. Innovation barriers refer both to the presence and absence of certain factors.

The development and implementation of ideas takes time and space. The reality is different, however. Competition within and between companies is intensifying as a result of increasing globalisation, faster and more complex information transmission and dissemination, and increasing customer demands. Time becomes short if the burden of routine work takes over and creative problem-solving takes a back seat due to the urgent daily business.

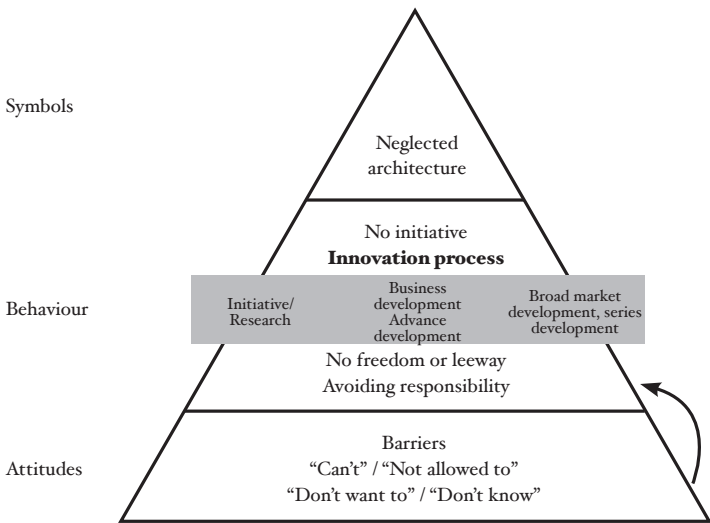
Routines in organisations are helpful in order to harmonise the processes in a company with a standardised approach and to design them more effectively and efficiently, however, there must still be enough freedom for the requirements of the situation to be handled flexibly. In situations where the daily work load is very high, on the other hand, staff can only react to requirements that have to be dealt with urgently. There is no time or opportunity to consider new ideas or to initiate innovations, i.e. to act in the sense of an innovating organisation.

Room for action that is restricted in this way leads to reactive handling of tasks in practice. In an environment which allows only limited freedom, employees behave passively, compliantly and with fear, ensuring that they move only within established boundaries.

The result is that, as soon as difficulties arise, the only work done is that which has been explicitly assigned and ordered, no plans are developed for dealing with problems in the future and environmental requirements are only countered reactively. This reactive behaviour is passive in the face of future problems and opportunities, waiting until they are encountered and only then reactive. Active problem and opportunity searches are not developed through this reactive behaviour, there is no back-up plan and no early warning system. A tendency to avoid responsibility arises and is reinforced. Consequently, this reactive approach is not successful.

Lack of time, overwork due to less profitable routine activities and increasing avoidance of responsibility represent serious barriers in an innovation process which manifest themselves in certain attitudes towards an organisation's pleasure in innovation. These barriers of "not allowed to", "can't", "don't know" and "don't want to" develop from corresponding experience or observation into permanent basic assumptions. They impact on current behaviour, even if the general conditions have now changed. They are basic assumptions of the members of the organisation which have a negative impact on the innovation process and which actually hinder it.





An extensive study of around 150 high-quality innovation projects has shown that the four-dimensional innovation culture outlined here has a direct, positive impact on the efficiency and effectiveness of organisations. Each individual dimension of the culture has been found to be critical for success.

- *Corporate freedom* has a significantly positive connection to the efficiency criteria (time and costs)
- *Communication / cooperation / conflict* has a significantly positive connection to the efficiency and effectiveness criteria (quality and technical success)
- *Dealing with errors* has a significantly positive connection in the early phases, in particular, to attaining the effectiveness criteria (quality and technical success)
- *Barriers* has a significantly negative connection, counter intuitively, both to the efficiency criteria (adhering to time and cost goals) and to the effectiveness criteria (quality and technical success).

The entire innovation culture model explains 6 % of the effectiveness and 7 % of the efficiency across industry. The success criteria named are general and cross industries. The innovation culture and the incentive system together explain 30 % of the innovative nature across industry.

This is why the incentive structure supports companies' abilities to innovate.

## **The incentive system as motivator**

Incentive systems have both a *motivation* and *control function*. This means they encourage and support the general performance of the employees, while also steering their behaviour to certain activities. Ideally, they support and reinforce the aims of the organisation by giving managers clear and consistent signals about which tasks have higher priority and about what behaviour is deemed to be appropriate or not. The type of reward strategy and the accompanying organisational practices are an expression of the values and orientations of an organisation, and therefore act as effective measures for supporting the corporate strategy.

Various empirical studies have shown that team rewards, in particular, can lead to intensive communication and cooperation with each other and to conflicts being handled constructively. Rewards based largely on individualisation, by contrast, prevents these interaction processes. In Capital Bank, therefore team rewards are assigned particular importance. The team concept supports the exchange of information and encourages intensive knowledge generation.



*The Service Award for service and staff departments ensures that it is not only advisors who profit from sales through direct contact with customers, but rather the whole team or rather internal, specialist employees (e.g. IT Service, Marketing, Settlement, Payments, etc.), which have crucially helped the success. Four times a year, elections are held, in which each employee of the internal services and staff departments can be elected. Employees in departments which make risk decisions are excluded in order to prevent possible conflicts of interest. At a joint celebration after the accounts have been prepared, the 10 best employees are rewarded and they get a proportion of the extra bonus provided according to the election.*

*The individual branches in Graz, Salzburg, Vienna, Kitzbühel and Klagenfurt are also rewarded as a team unit with each being awarded a quality-calibrated team bonus. The distribution key applies to the team leader and is ideally determined and distributed by the entire team. The agreement processes play a central role here.*

*Advisors and customers can also be understood as a team. Because the conversion to the fee-based and success-based private banking concept in 2009 passes on all brokering and portfolio commission in full to the customer. There are no explicit sales requirements, so that income is earned on the basis of joint success and not on the sale or the product. A reward of 15 % of the net profit encourages individual performance and supports the willingness to assume responsibility. This is also supported by the fact that the fee is waived if there are losses, until the previous success has been restored. In principle, the success of the individual portfolio and the satisfaction of customers are our profit and thus supports our primary corporate goal. It is supported by an innovation-promoting organisational culture and a corresponding incentive system.*

## Outlook

Added value is essential for the success and existence, not only of banks, but also of every single company, and thus above all is a strategic and management task. In order to create added value, numerous *activities* are necessary and a *working environment* must be created which motivates and supports all employees to use their potential and to work towards this goal. Their ability to innovate and their willingness to use innovations are important starting points for any company.

For companies are faced with increasing *competitive pressure* due to ever shorter product lifecycles and increasing cost pressures on global markets. More than ever before, they are forced to build up and defend strategic unique positions. Market share has to be maintained, the product range expanded, quality and efficiency increased and costs reduced. Together with the reduction in global knowledge differences, competition is intensifying, especially for companies

and industries which have previously had a relatively unassailable global market position.

The added value created by the innovation capability as a higher ranking corporate goal means both *retaining value* and, in particular, *increasing value*. Creating added value in a company is positively supported, if not made possible, by a vital culture of innovation.