THE OPEN INNOVATION MODEL: EXPLAINING THE FACTORS THAT HINDER ITS IMPLEMENTATION IN THE ALBANIAN BANKING SYSTEM

Besarta Vladi, European University of Tirana, besarta.vladi@uet.edu.al

The implementation of an open innovation model is considered by many researchers, to be a great opportunity to help profit-making organizations become more competitive and successful. But some sectors, such as the banking sector, are not able to apply this model. In the Albanian banking sector, the concept of an open innovation model is almost unknown to executive directors. The question is: Why does this happen? The implementation of an open innovation model is strongly affected by cost, short term focus, legislative problems, lack of information, and frequently by a lack of interest in cooperation. As a possible solution for this problem, especially during the financial crisis which has impacted Albanian as well as the rest of the world, raising a strong awareness of the importance of this model could be one route to improve the level of competitiveness in the banking sector.

JEL Classification Numbers: O31, O32, Q55, **DOI:** 10.12955/cbup.2013.16

Key words: innovation, open innovation model, banking system, competitiveness

Introduction

The differences between closed and open innovation models have been the subject of many analyses and scientific studies. As a definition, Rogers (2003) said that innovation, in general, is an idea, practice or object that is perceived as something new by its adopters. Also, Chesbrough (2006) has mentioned that open Innovation, as a new paradigm is “the use of purposive inflows and outflows of knowledge to accelerate internal innovation, and expand the markets for external use of innovation, respectively”. Open Innovation in this case assumes that ideas come not only from the inside, but also from outside the organizations. These ideas can be taken to the market through external channels, outside the company, to generate value. Open Innovation assumes that useful knowledge is widely distributed, and that even the most capable R&D organizations must identify, connect to, and leverage external knowledge sources as a core process of innovation. There are at least four open innovation models. Besides the model elaborated by Chesbrough (2006), another open innovation model was described previously by Hippel (1988), and is known as ‘Distributed Innovation’. The latest models, the ‘Knowledge-Creating Ba’ model, created by Nonaka (1998) and the ‘Downstream Innovation’ model created by Tuomi (2009), have led to extensive debates in various research environments. Despite many differences amongst these open innovation models, all of them reject the idea that innovation in itself is a closed process. However, the problem for some organizations such as banks arises exactly in the moment that they have to distribute and share useful information and knowledge with others.

Many authors, such as Hippel (1988), Dahl & Pedersen (2004) consider the flow of information as 'a buying and selling' process. Referring to Hippel (1988) an information exchange between different firms looks like a business amongst few people. Other researchers think that it is more profitable to share new information and innovative ideas than to sell them. Morrison et al. (2001) has mentioned that free library information systems (especially online libraries) are a good example of sharing information. Hippel (1988) said that other sectors that use the sharing information process are medicines/pharmaceuticals, technology, chemistry analyzers etc.

The reasons why they decide to share information might be very different. As Raymond (1999) mentioned, some of these organizations need financial support, others need to improve their reputations by collaboration, or simply to test their new ideas. Nowadays most banks look to sell their innovative ideas. Fasnacht (2009) said that 'Openness is an essential prerequisite for the ability of modern financial firms to achieve differentiation, expertise, and specialization on the supply side, while providing superior service to highly satisfied customers on the demand side'. Nevertheless, the banking system is one of the sectors that in most cases does not seek to share information or innovative ideas. Open innovation is an unknown term for many of them.

Innovation in banking system: A Global perspective

Open innovation is the second step, the first one is being an *innovative* company. Innovation in the banking system, is first of all related to infrastructure improvements that foster efficient financial services. Fasnacht (2009) said that the focus of an open innovation paradigm 'lies in openness, flexibility and customer integration with the corporation, as the dominant organizational model'. Sectors such as manufacturing are good examples for banks, if they want to observe the advantages and implementation of various forms of open innovation models.

Innovation theory and especially an open innovation model is a crucial factor for banking system service improvement. Modern payment systems need to be part of any bank which wishes to be successful and competitive. This model has transformed the entirety of banking technology already. Nowedays, as Fasnacht (2009) mentioned, customer expectations are extraordinarily high and this is 'forcing banks to look for new sources of competitive differentiation, efficiency and revenue'.

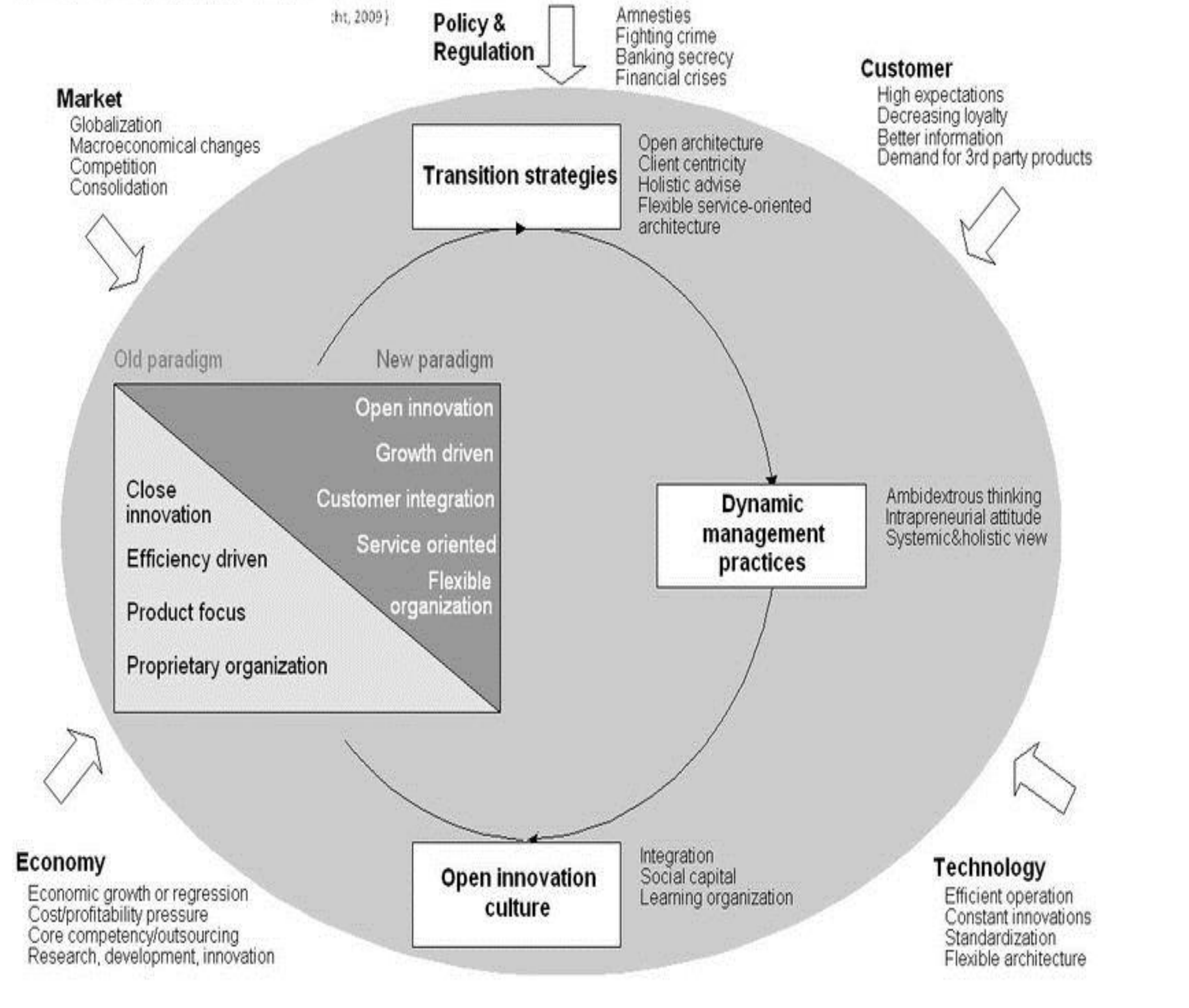
The banking system has not been famous for its approach to use innovation. According to Forbes (2013), only two banks (HSBC and Banco Santander) were listed among the world's 50 most innovative companies during the last year. But the global financial crisis of recent years has changed the competitive strategies for almost all sectors, including banks. Organizations can no longer rely on products or services alone to differentiate themselves from other competitors in the market. They need innovative ideas and an open innovation model.

Fasnacht (2009) claims that the financial service industry is currently undergoing a radical transformation. Despite the fact that the banking system has evolved, the financial services sector is still far way from being a good adaptor of an open innovation model. There are different barriers for open innovation in this sector such as its Short-term focus, Risk-averse culture and its lack of internal capability. For many sectors the transition to open innovation is a difficult, complex and long process.

However, during the last few years advanced technology has become an emerging key driver for innovation in the business and financial services sector. The integration process between advanced technology and data analyses has been a determinative element for the future of the banking system.

'This integration of technology has enabled platform innovation in the financial sector, for example, the shift from paper money to plastic money to the mobile wallet. As Golightly (2012) said, digital consumer-banking applications like Pingit – the consumer mobile banking transfer 'app' from Barclays – show the disruptive forces which can play a crucial role in the sector'.

Figure 2: Open innovation model and banking system



Source: Fasnacht (2009)

Using Chesbrough's (2006) concept of a Collaborative and open innovation model, he mentions that this kind of collaboration with the main focus on generating innovative ideas, is based on knowledge sharing and long-term partnerships. This looks difficult for banking organizations because they think that sharing ideas means losing strategic information. The future of each company is in using a client-focused organization process. But if banks operate as a closed system, they will not be able to know what exactly their clients want. Client satisfaction levels make the difference between successful and unsuccessful companies in the financial market. Fasnacht (2009) mentioned that banks must adopt flexibility and build up service-oriented open business models to innovate and rapidly redefine themselves as markets and client behaviors have already radically changed.

According to Golightly (2012) and his analysis about the relationship between various economic sectors with the concept of an open innovation model, the ICT and pharmaceutical sectors have the longest-established Open Innovation programs. The Media and Business & Financial Services sectors have also made slow progress towards Open Innovation in response to the pace of technological change, and consumer demand. Advanced Manufacturing and Energy are more recent adopters of Open Innovation, but they have been moving quickly into these areas more recently.

The implementation of an open innovation model in the banking system is really important for the future of this system. Through innovation, this system manages to reduce costs in the long term perspective, to be more competitive in the market and to be more satisfactory for their clients. The change from a closed system to an open and collaborative one helps banks to reduce risk across the financial markets. According to Fasnacht (2009) 'The real vulnerability is not the network of partnerships; it is the highly complex and global financial system and the management of the risks coming with open business models'. Although, open innovation does not protect banking system from all of the potential risks that banks deal with. 'Open innovation concepts applied to the financial services may have an important contribution to the change required in setting up more sustainable business models'.

Open innovation in a banking system: the Albanian context

The banking system in Albania is one of the main sectors of the country's economy. The European Union (EU), which Albania aspires to join as soon as possible, has set clear objectives related to research and innovation as part of the "Europe 2020 Strategy". Albania has made significant progress in transition reforms in recent years, but important challenges remain. First banking activities in Albania started in 1913, by the establishment of the Central Bank. Nowadays the Albanian banking system has more than 15 private banks which conduct activities in Albania. Most of them (more than 60%) are branches of foreign banks.

It is important to mention that according to the IMF Report (2012), the Albanian economy has successfully avoided a serious decline in growth and financial instability since 2009, but still this economy is weakening and macroeconomic imbalances are evident. By using fiscal stimulus, sound monetary policy and effective macro prudential actions, the Albanian government has largely avoided the negative effects of the financial crisis. But today, policy buffers are exhausted, macroeconomic imbalances persist, and with the ongoing euro zone problems, the economy has slowed. The financial sector is exposed to domestic and external risks, and incomplete investment climate reforms constrain medium term growth.

One of the main challenges for the future of the Albanian banking system is innovation in this system, the implementation of an open innovation model, the introduction of new technology such as e-banking, mobile banking, direct debiting etc. In general terms, as Fasnacht (2009) claimed, the banking systems lackluster performance and non-innovative character can be attributed to three important reasons. Rehder and Levi (2011) have analyzed these reasons which are: '*Short-term focus'*: Banks do not accept or understand how innovation contributes to the wider business vision and benefits. For this reason many of them fail to develop a concrete innovation strategy. The second reason: '*Lack of internal capability'*. In most cases, CEOs do not accept this fact as a reason for non development of innovation. They think that the real reasons are related with costumers and market politics. From their point of view 'Low customer relevance and slow speed to market are the top reasons for innovation failure'. The last one is a *Risk-averse culture.* 'Heavy regulation and strict compliance requirements have produced a banking industry that is conservative and risk averse by nature'.

To analyze the situation in Albania's banking system, ten executive directors from ten different branches of banks in Albania, participated in semi-structured interviews. After a free discussion about the Albanian banking system in general, they were asked specifically about the reports on innovation in their banks, and especially within the concept of open innovation. With regards to the components suggested by Fasnacht (2009), as factors that hinder the spread of the open innovation model in the banking system in Western countries, their attitudes are relatively different.

Table 1: The results of the interviews

	Short-term focus	*Risk-averse culture*	*Lack of internal capability*	Other
Interviewee no:1	-	+	+	High cost (unsupported)
Interviewee no:2	-	+	-	Not interested on it
Interviewee no:3	-	+	-	Legislative Problems
Interviewee no:4	-	+	-	Unfair competition
Interviewee no:5	-	+	-	Low dynamic trade do not require high attention in innovation
Interviewee no:6	+	-	-	High cost (unsupported)
Interviewee no:7	-	+	-	Lack of cooperation
Interviewee no:8	-	+	-	Hierarchical structure
Interviewee no:9	+	+	-	Not enough information
Interviewee no:10	+	+	+	Legislative Problems

Source: Author

When considering the first factor, the short-term focus, 70% of the respondents did not accept the fact that the inapplicability of the open innovation model comes as a result of their short-term vision. On the other hand, 90% of them have claimed that such a situation is as a result of the Risk-Averse culture, considering Albanian culture as a part of the general European culture which is not generally known as risk-taking, when compared for example with American culture. Only 20% of respondents acknowledge that the lack of open innovation is as a result of a lack of internal capability.

Meanwhile, in addition to the three options available, they have been asked to add at least one other element, which in their opinion, could be an obstacle to the development of open innovation in the banks which they are responsible for.

Elements such as the high cost of the implementation of this model, no interest in this model, its functioning legislative barriers, hierarchical structure, unfair competition, lack of cooperation and lack of sufficient information about the advantages of this model, are additional elements that they mentioned as answers to the question about which factors hinder the implementation of an open innovation model in the banking system in Albania.

Conclusion

The banking system is one of the most important parts of the overall economy of any country. While the impact of the global crisis has affected the majority of economies worldwide, the implementation of an open innovation model can help the banking system to become more competitive. Nowadays, open innovation models are not very widespread in the banking system even in the most developed countries of the world, and this happens for many different reasons. The results of a study conducted in the Albanian banking system show that these limiting factors, range from cultural elements, cost or lack of information, to the lack of interest in this model. A first step toward solving this problem is to increase the awareness of senior banking executives about the competitive and strategic importance of innovation and adopting an open innovation model. This awareness can be increased by organizing various seminars and trainings, on a national and international level, with a specific focus on open innovation in the banking system.

References

Allen, R. (1983). Collective invention. *Journal of Economic Behaviour and Organization*, 4, 1-24. doi: 10.1016/0167-2681(83)90023-9

Chesbrough, H. (2006). *Open Innovation: A new paradigm for understanding industrial innovation*. Oxford, England: Oxford University Press.

Dahl, M. & Pedersen, Ch. (2004). Knowledge flows through informal contacts in industrial clusters: myth or reality? *Research Policy - Elsevier*, vol. 33 (10).

Fasnacht, D. (2009). *Open Innovation in the Financial Services*. Berlin, Germany: Springer.

Franke, N. & Shah, S. (2003). How communities support innovative activities: an exploration of assistance and sharing among end-users. *Research Policy*, 32, 157–178. doi: 10.1016/S0048-7333(02)00006-9

Golightly, J. (2012). *Realising the Value of Open Innovation: The work Foundation*. Lancaster University, UK: Big Innovation Centre.

Harhoff, D., Scherer, F. & Vopel, K. (2003). Citations, family size, opposition, and the value of patent rights. *Research Policy*, 32, 1343-1364. doi: 10.1016/S0048-7333(02)00124-5

Hippel, E. (1988). *The Sources of Innovation*. Oxford, UK: Oxford University Press.

International Monetary Fund. (2012). Article IV Consultation: Albania. *IMF Country Report No. 13/7*, Washington, D.C.: Author.

Morrison, J., Pirelli, P. & Card, S. (2001). A taxonomic analysis of what world wide web activities significantly impact people's decisions and actions. *Proceedings of the SIGCHI Conference on Human Factors in Computing Systems (CHI'01) held in Seattle, WA, March 31 – April 5, 2001*. (p. 163–164). Retrieved from http://dl.acm.org/citation.cfm?id=634167

Nonaka, I. & Konno, N. (1998). The concept of 'ba': building a foundation for knowledge creation. *California Management Review*, Vol. 40, pp. 40-54. doi: 10.2307/41165942

Raymond, E. (1999). *The Cathedral and the Bazaar: Musings on Linux and open source by an accidental revolutionary.* Sebastopol, CA: O'Reilly.

Rehder, P. & Levi, D. (2011). Innovation Excellence: What Banks Can Learn from Top Innovators in Other Industries. United State: Accenture. Retrieved April 10, 2013, from http://www.accenture.com/SiteCollectionDocuments/PDF/Accenture-APAC-BNK-BrightIdeas.pdf

Rogers, E. (2003). *Diffusion of Innovation* (Fifth Edition). New York, NY: Free Press.

Schrader, S. (1991). Informal technology transfer between firms: Cooperation through information trading. *Research Policy*, 20 (2): 153- 170. doi: 10.1016/0048-7333(91)90077-4