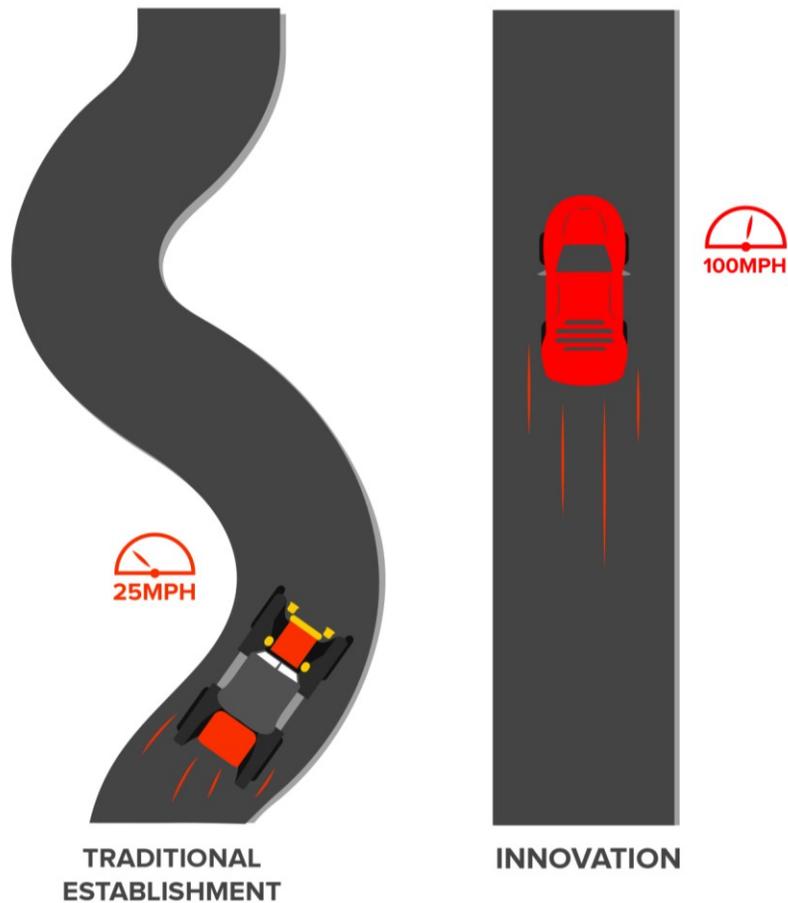


The Value of Operating Velocity

By George Castineiras, Alexander Isakov & Arnav Tripathy



“What happens when you place either car on the opposite road?”
See last page for answer.

Keeping the main Organization and Innovation moving smoothly comes down to a combination of the Car, the Driver, and the Environment. Do you know where you are going and how to get there? While you use sophisticated models to forecast the financial and political environments, what framework do you use to adapt to the exponential disruptor in the environment? In this paper, we argue that Operating Velocity is the key tool.

Operating Velocity: Why You're (Not) Benefitting From Innovation

What if you could build a company with the reach of Uber within your own organization? What if you could do so within the next two years? This is the sort of challenge that you can – and should! – be setting for yourself, but successfully benefitting from such innovation goals requires a firm understanding of your Operating Velocity. Otherwise, you risk not turning innovation efforts into long-term success, opening you to risk from the coming disruption in the financial service industry over the next three to seven years.

Investments in insurance and banking continue to accelerate globally. Since 2015, over \$4B have been invested in InsurTech alone¹. Every established company executive recognizes that the world is moving at a “rapid pace”. Everyone wants to “innovate”, and the largest insurers and banks spend billions of dollars on innovation efforts. Yet, few established institutions reap the full benefits of successful innovation. Why?

Based on research conducted with the Pallantius Velocity Framework, we find that the main factor in your organization’s preparedness for the future is Operating Velocity, or your speed of impact on *customer outcomes*. Operating Velocity has three components: Performance, People, and Process. An organization with high Operating Velocity has the capability to incorporate emerging technologies, has the right talent in the right roles, and can make decisions effectively. Just like the speed of a real-life car, measuring your Operating Velocity tells you the actual speed with which you move from Point A to Point B. You might have a Ferrari (high Performance), but if you’re driving through Boston traffic (low Process), a bicycle can overtake you.

Change is Constant, Velocity is Not

What does this have to do with innovation? What makes the world today different from the world of 100 years ago is not that it’s rapidly moving, but that it’s **rapidly accelerating**. Companies that follow traditional patterns of business continue to move forward linearly, whereas those that effectively and consistently incorporate strategic innovation move exponentially – creating an ever-increasing gap in performance with their linear counterparts². Exponential organizations can adapt to changing technology and environments, incorporating advances into the core business to remain on the cutting edge. Linear organizations, by contrast, will usually be limited by their traditional processes. This leaves traditional organizations at risk of falling further and further behind.

Unfortunately, the threat of exponentials is difficult to assess with traditional thinking until it is too late. Suppose a traditional Established Institution, BigInsurCo, has been in business for 100 years. Over that time, it has acquired 100 million customers. Suddenly, an innovative company ModernInsurCo emerges – a fully digital, cloud-based technology solution that integrates big data and AI. It offers simplicity and personalization, and attracts 10,000 customers in year one. If each of these customers refers 3 other customers per year – say a millennial shows it to her parents and one of her friends – in one year, it will have 30,000 customers; in 5 years, it will have 2.4 million customers; and in 7 years, over 20 million customers. In other words, it’s not a big player and is often ignored, until it emerges seemingly “unexpectedly” and creates a massive problem for the established order. And this is a conservative rate of growth – it is well-known that network effects

¹ <http://www.businessinsider.com/the-fintech-report-2016-financial-industry-trends-and-investment-2016-12>

² Ismail, Salim. *Exponential Organizations*. 2014.

around significantly superior experience can cause viral adoption. Indeed, we see cases of this effect driving companies to create billions of dollars of value in 7-10 years (Google, Facebook, Uber) and outcompeting companies that have existed for decades.

But that's not the full story. For the disruptor, marginal costs continue to decrease and revenue continues to improve as the exponential technologies it's built on explode in usefulness. Suddenly, it can increase its product range and cut into more parts of the value chain (driving organic growth), or even expand into a platform and become the critical gatekeeper to BigInsurCo and its traditional competitors. ModernInsurCo now fully owns the customer and, crucially, the customers' data and trust. When Pallantius interviewed a range of top European banking executives in late 2016, one message was clear: "we thought we had consumer trust because of our brand, but a larger and larger base of our future ideal customers trusts Google more to give them the answers". In other words, the longer you wait to take action, the bigger the gap, and the more future (and current) customers are permanently lost.

Many verticals in the banking and insurance industries are undergoing severe disruption by young "nontraditional" companies with a high Operating Velocity. While an established institution executes on one important improvement to customer outcome, a young company executes on at least six. Let's look at two recent examples. The startup N26 launched in Germany in January 2015. Its goal is to allow you to run your whole financial life from your phone. It is fully digital, allows opening an account in under 10 minutes, and is developing a full suite of banking products. In 2 years of business, it attracted 200,000 customers in a heavily over-banked country and is growing rapidly, consistently using Data Science and staying at the cutting edge of user experience. More generally, in the banking vertical, an emergent Banking as a Service philosophy provides an illuminative example of an industry changing exponentially as it meshes seamlessly with other offerings³. The organizations that embrace this financial analogue of Software as a Service understand that the modern consumer expects and demands completely personalized control over every aspect of their financial footprint. For established banking institutions to preserve their dominance throughout the value chain, they need to be prepared to continuously compete for each consumer and expand their services to encompass all aspects of daily life.

In the US insurance market, startups are slicing up the value chain and disintermediating advisors and distributors by selling direct to consumer and creating a "one stop shop" for all insurance purchasing needs. Consider the startup Lemonade, itself a fully-licensed insurer offering simple, transparent pricing, a focus on shared user community, and a great digital experience for renters and homeowners (starting in New York). While starting small, its "all-digital" platform can allow it to scale rapidly and eventually enter new lines of business, all while collecting valuable data on customers that can be used to optimize its products. Indeed, Lemonade recently paid an insurance claim within 3 seconds⁴. This type of disruption is already underway in health, life, P&C, and retirement.

In short, expecting to permanently own a customer based on classic value propositions and being a "necessary intermediary" is legacy thinking. Having the ability to efficiently incorporate a range of

³ <http://www.bank-as-a-service.com/>

⁴ You read that right. <http://www.prnewswire.com/news-releases/lemonade-sets-new-world-record-300386198.html>

converging technologies from Artificial Intelligence to the Internet of Things will allow continued growth and leadership, and this is only possible by understanding and optimizing the Operating Velocity at the core of the traditional institution.

What Is the Optimal Velocity?

While the knee-jerk reaction may be “as fast as possible”, the reality is that moving at the pace of a young company can be just as dangerous to an established institution as moving too slowly. Yet, the current innovation environment that is being implemented tends to follow what we call the Barbell Model: a slow legacy approach to business in the “core” and a fast innovation system on the “periphery”, often in the form of an Innovation Lab. But, if the velocities of the two are highly mismatched, there will naturally be a high level of friction that results in little benefit from innovation. On the other hand, a healthy (but not widening) gap between the periphery and the core over a sufficiently long period of time allows the former to create new solutions and the latter to manage risk, enabling a smooth transition and maximum benefit.

Given that the biggest risk of fruitlessly losing resources occurs when the gap between the periphery and the core gets too wide, it is important to understand not only what the Operating Velocity of the core is now, but also its trajectory. Otherwise, while efforts may seem to start off strong, eventually they give rise to excessive friction and result in wasted resources (see Figure 1). While we have observed precisely this pattern in at least four major insurance companies in the last two years, the good news is that by firmly understanding Operating Velocity, you can form a happy marriage between the Innovation Periphery and the Organizational Core.

The Foundation of Success

Our research indicates that established companies need to reassess their key competitive advantages in terms of successful innovation. Unlike young companies, established institutions have the capacity to take more shots on goal (*large balance sheets*), take more accurate shots on goal (*historical data*), and score points more quickly due a wide range of immediate potential adopters (*customer base*). Younger companies, on the other hand, can use the newest technology (not encumbered by legacy systems) and fresh talent to generate new ideas.

By understanding the factors that cause speed-up vs. slow-down and lead to the current Operating Velocity, companies can better understand what concrete actions they can take to use their strongest assets to optimize the velocity across the organization to the point where innovation can be both successfully catalyzed **and** successfully incorporated into core processes.

Now we can return to the question we first asked: what if you could build a company with the reach of Uber within your own organization in the next two years? As you now know, the answer is that it wouldn't do you any good if the Operating Velocity of the Core Institution did not remain within a narrow band of the Innovation Branch. On the other hand, if the Operating Velocities would remain close enough for effective execution over time, you would be in a strong position to remain relevant and lead long into the future.

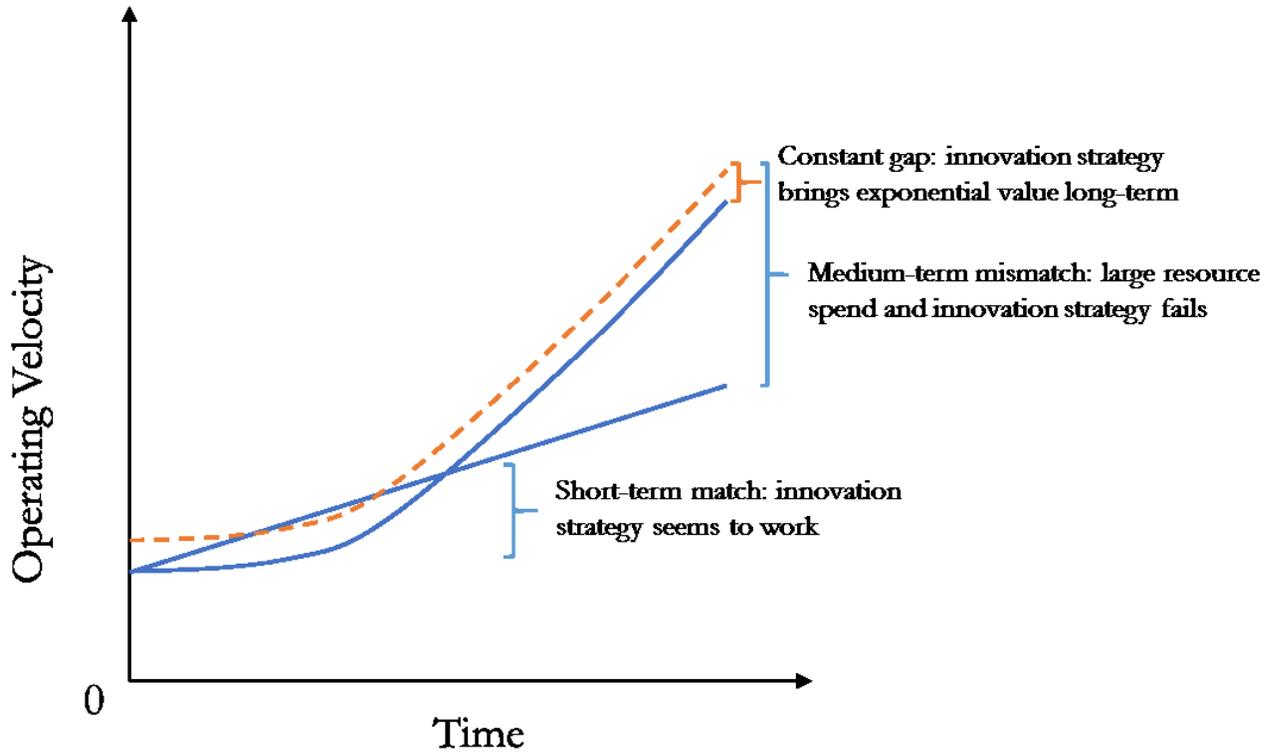


Figure 1. Matching velocities between the core and the innovation unit and moving away from the “Barbell Model” is the key to getting long-term strategic benefits from innovation. The solid blue lines show two scenarios for the Operating Velocity in the Core Organization: exponential and linear. The dashed orange line shows the typical exponential velocity of innovation. While in the short run it seems that the linear velocity of the core and the exponential velocity of innovation match up well (“hope for success”), they diverge and the gap widens in the medium-term, leading to implementation failures, friction, and frustration. On the other hand, by nudging the velocity of the Core Organization up continuously, even though it remains below that of the innovation unit (as it should to prevent excess risk), the gap remains within the optimal regime – it never widens. This creates an opportunity for successfully profiting from innovation and avoiding disruption.

The Authors



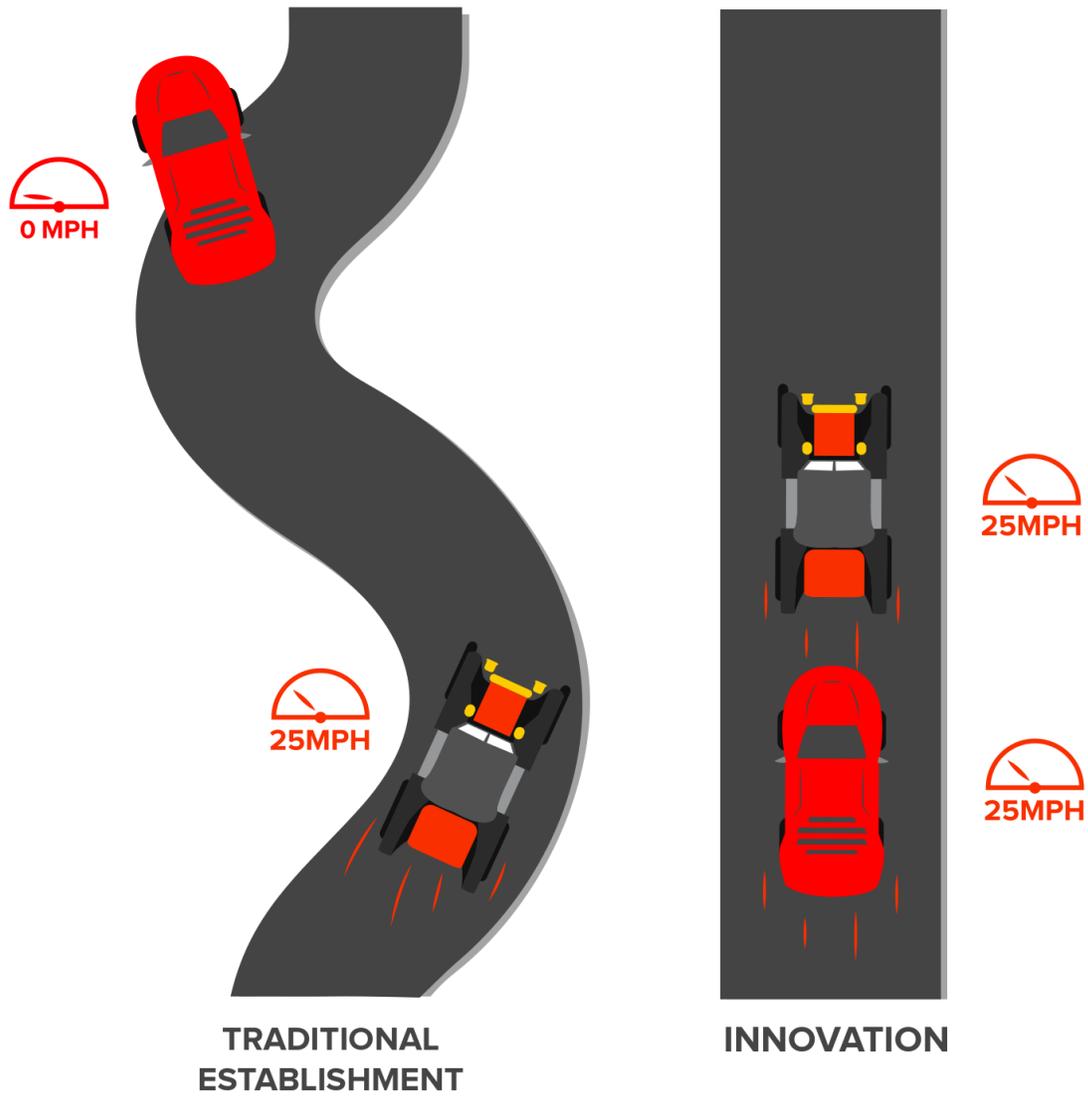
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About Pallantius

We are an Established Institution Accelerator. Our mission is to ensure that established institutions in Banking and Insurance remain meaningfully relevant over the next decade by enabling enduring success in innovation. We understand that the first step to this is understanding and optimizing Operating Velocity.

The name Pallantius brings to mind an ancient Greek connection to Wisdom, Innovation, Craft, and Leadership. Our company strives to embody these attributes through a combination of talent in insurance, banking, and science with degrees from Harvard, Stanford, and MIT.

For more information and to get a first glance at your own company's Operating Velocity, visit www.pallantius.com and take the 5-minute survey.



Innovation operating in a Traditional environment derails.
Traditional operating in an Innovation environment is business as usual.
The key to success is optimizing Operating Velocity!