Will Social Networking "Rock and Roll" Financial Institutions?

Analysts:

PERSPECTIVE #

Sean O'Dowd	Li-May Chew
Patricia McGinnis	Aaron McPherson
Rachel Hunt	Dana Gould
Jeanne Capachin	Barry Rabkin
Rachel E. Happe	Bill Bradway

IN THIS PERSPECTIVE FinSightsAdvisor

FinSights Advisor is a weekly perspective on the financial services industry. It provides financial institutions with timely guidance about maximizing ones technology investments. This week's issue focuses on social networking. Social networking is rapidly expanding beyond the likes of MySpace and Facebook into the corporate world. Will social networking impact a financial institution's business model? What should financial institutions do to comprehend and cope with new, unstructured, and dynamically evolving digital communities? Institutions need to operate on Internet time to be relevant.

This perspective will provide a framework that defines social networking for all three financial industry segments (Banking, Capital Markets, Insurance) as well as provide guidance to financial institutions, FinTech and infrastructure vendors and investors.

Background

Fifty years ago, "Rock and Roll," exploded into the music and entertainment world just as the early baby boomers were becoming teenagers. Older generations scratched their heads, wondered why this music was so appealing, and asked how rock and roll could be so influential, in so many ways, to a new generation of adults. Today's successful financial institutions have been able to ride their business opportunities that resulted from the baby boom's generational wave. Most observers would agree that today's leading financial institutions are dramatically different from the industry leaders of the 1950s.

Is there another transforming phenomena, social networking, that has already begun for the Gen Yers? Can today's financial institution managers afford to scratch their heads and wonder why so many teenagers and young adults have flocked to MySpace, Facebook, and other online social communities? To look for relevant answers requires an understanding of the social networking world. IDC's published *U.S.*

Global Headquarters: 5 Speen Street Framingham, MA 01701 USA P.508.620.5533 F.508.988.6761 www.financial-insights.com

Social Networking Application 2007–2012 Forecast and Analysis (IDC # 208313, August 2007), provides the relevant framework for this subject. "Social networks, the term commonly used as the shorthand for social networking services, refers to a wide variety of Internet offerings that are quite different from one another. At the most basic level, social networks share three features:

- **Persistent online profiles:** User presence, typically visible via a profile or collection of content and comments. Social networks enable users to present themselves to the world. This may happen either by means of a personal profile page or through content a user publishes, whether a post on a blog, a video on YouTube, photography on Flickr, or certain shared music selection on Launchcast Radio.

- **Linking among profiles:** Networks need the ability to link between users and make connections, thus creating a networked ecosystem of nodes. Social networks allow users to interact with each other in a variety of ways, whether via email, instant messaging (IM), chat, publicly posted messages, or voice and video interaction.

- **Interactive functionality:** Social networks offer functionality that enables interaction between users, which also adds richness and informs the community about the user."

While the genesis of social networking sites like MySpace and Facebook took off with young consumers, the enabling framework and technologies of social networking are analogous to the music world's framework and its infrastructure which served to launch rock and roll. No doubt, many financial industry employees have already joined at least one business centric social network, such as LinkedIn. Others have located online communities that relate to a financial service. Online investing offers a useful example of social networking applied to a financial service. Originally, social networks followed the publish and interaction platform with limited tools for end users. Many social networks now allow community members to manage their network contacts, albeit some make it easier than others. Before exploring how the social network can impact a financial institution's business model, some additional points of reference regarding social networking will be helpful.

There are a variety of social networking models to keep in mind. The broad-based social networks sponsored by firms like Yahoo! Groups (**groups.yahoo.com)** , Google Groups (**groups.google.com**) , and the Motley Fools Community Discussion Boards have social networking facilities included as part of a broader presence that can include live chat and email. In some instances, participants have experienced an adverse consequence from participation – such as the "pump and dump" scheme used to hype a stock to stimulate buyers that drive the price up while the promoter dumps it. In the financial industry, websites like TradeKing (www.tradeking.com), Zecco (www.zecco.com), thinkorswim (www.thinkorswim.com), UpDown (www.updown.com), and Fynanz (www.fynanz.com) have social networking integrated within their online presence and require that end users join their network. Trade King, Zecco and thinkorswim are examples of retail online brokerage firms with online networks that provide better transparency to curb "pump and dump" activity. One example of a bank's take on social networking is Umpqua Bank (**www.umpqua.com**), which launched Umpqua LocalSpace™, a virtual networking service that connects members with local community resources. Other examples of financial institution initiatives in social networking include Royal Bank of Scotland, which created a presence on Facebook. Other institutions have permitted their employees to use LinkedIn (**www.linkedin.com**) to reach out via their personal networks to stimulate recruiting efforts. JPMorgan maintains an alumni site (www.alumniofjpmorgan.com) as a way to engage departed staff, retirees and mothers and present opportunities to come back to firm. A good example of internal use is seen at Northwestern Mutual, which uses internal blogs to capture the wisdom of departing agents.

Have financial institutions sensed a changing landscape due to social networking? Do any of them feel at risk from the unknown potential of social networking? Most likely "no" and "no" are the answers. Are there some low hanging Social Networking fruit that institutions can pick? Remember the discussion from last week's Perspective, *How Will Digital Marketplaces Change the Game in Financial Services?* (Doc # FIN212162, May 2008) We provided several examples of disruptive initiatives. A game can change quickly, so institutions should at least consider how to assess the threats and opportunities that may emerge from social networking.

Timing

Some financial institution managers may be thinking "we'll do it (social networking) when we have to." Well, their predecessors thought that way about the Internet and online (banking, investing, insurance) financial services. Social networking is already here and it also operates on Internet time. So, "when we have to" may well be sooner than managers with these opinions realize. Managers who wait for a "killer app" for financial services on top of a social network are using the wrong paradigm. The Internet has been about so much more than online financial services. The same is already true for social networking.

Assessing the Impact

Financial institutions should reflect on how social networking can impact their business. Several issues are listed below and should be given more than a lunch time's discussion:

- Use scenario analysis to "what – if" your key products and services, looking for disruptive developments that could engage a large interactive audience that responds to changing the deal or means of fulfilling their needs. While this may seem abstract, the lessons are analogous to examples like how Intralinks displaced FedEx, which in turn displaced USPS. Also, check imaging and remote deposit capture are displacing the overnight couriers and Fed check clearing facilities. Evaluate how web-based alternatives like Zecco, Fynanz, or Zopa (**www.zopa.com**) are using social networking to develop competitive options to traditional institutions.

- Revisit the business value proposition at the front end of the business model we discussed in Digital Marketplaces Perspective. Imagine or visualize how a viral-based network effect could enhance or disrupt the financial institution's business development and sales/booking pipeline. Explore the potential impact that social networking could have with internal and enterprise communities, which can be expanded to include a vendor'S or an institution's business customers. Examine the potential impact on the institution's business velocity.

- Explore the possibility of creating a "sticky" online presence that leverages a social network. For example, "local" institutions could participate in their community's social network as it develops. Finding ways to add to the experience of a local bank's key constituents might add to these relationships.

- Service fulfillment – rethinking, and either modifying or reengineering some workflows to enable accelerating processes that result in business. In 1998, how many bank CEO's ever thought that a customer would be able to open and fund a new checking account at a competitor online? Explore how social networking could stimulate positive discussion about an institution by spreading the word about a positive opportunity. Alternatively, this venue could also serve to short circuit a negative development at an early stage.

- Financial institutions need to assess the potential reputation risk that could occur in a social networking environment. Websites like **www.complaints.com** and **www.my3cents.com** exist as virtual "consumer feedback" sites. Financial institutions may wish they had implemented monitor tools to capture and analyze the unstructured data from these websites. Some institutions, like Bank of America, have begun to support online customer comments, both positive and negative, on its website (**www.bankofamerica.com**). Authenticity is an important attribute to make this effort effective.

- There are four imperatives that seek an elusive state – perfection. Transparency – an institution needs to be able to prevent illegal or unfair exploitation like the “pump and dump” trading scheme. Privacy – no mistakes please. Security – also, no mistakes please. Compliance – one more time, no mistakes please.

Guidance

Is your organization already thinking about social networking? The good news is that the party is just starting and it is not too late. All industry players (financial institutions, FinTech vendors, infrastructure vendors, and investors) need to think about how to discover, catalog, map and track the evolution of new social networks that intersect with customers and financial services in one way or another.

Financial institutions have the most at stake. Ultimately, long term survival will require an adaptability as social networking formulates its value propositions. At this early stage in the development of social networking, leveraging the existing sites will be the most effective tactic. At a minimum, financial institutions should keep a close eye on what is being posted on the major social networks like Yahoo! Groups and the growth rates at companies like Zopa, Prosper, and Fynanz. Larger institutions may consider organizing a rapid response team to deal with harsh negative attacks that may occur on these boards. Reputation risk is one area to monitor continuously. One form of social networking can have a viral-like intensity that can surface overnight if there is a shred of data that suggests an institution’s actions were inappropriate or treated a group of consumers unfairly. Think of the class action lawsuit on digital steroids. By posting the institution's version of events, they can stem the damage before it gets out of control. Conversely, social networks can be a fertile ground to harvest insights. Institutions can mine social networks for ideas about new products, new features, or new technology acquisitions by monitoring postings.

Along a more positive line of thought, financial institutions can carve out and serve a loyal community of members – customers. For example, a community bank may have the capability of using a social networking function within its website to engage customers on community issues, events, and allow the community members to help shape the dialogue. Banks, such as Wainwright (www.wainwrightbank.com) who displays a strong sensibility for social and community causes could benefit from exploring the use of social networks. Customers for life – in both physical and virtual domains – should be the goal. Admittedly this approach will only work for some, not many, community banks. Another factor to consider is to prepare the institution for tomorrow's key customers. What are they going to demand? As mentioned above, transparency, privacy, security, and compliance are all critical areas that should be treated comprehensively and reviewed regularly to limit risks.

FinTech vendors may struggle with social networking. A vendor should, and may well already, think of its financial institution end users as a community. A vendor should look for ways to engage social networking with its community members. A new business, or services offering, could emerge that enables a FinTech vendor to supply a desired solution that supports the next generation of financial services.

Infrastructure vendors that have a strong financial industry vertical presence may have an opportunity to use social networking and gain new opportunities at the expense of the FinTech vendors. This is not a straight switching game but rather a way to model the transformation, much like how unified communications has triggered the transformation between voice, data, and video communications. If the FinTech vendors act like some of the land line telephone companies, they will also be marginalized.

Investors have to be delighted with a new technology form factor emerging. Creativity, preparedness, and timing could well converge in the next 12 to 36 months that will lay the foundation for the next decade of change in the financial services industry.

At some point in the future, we will know how social networking evolved in financial services. Will it have a long lasting impact that can influence a generation of tomorrow's adults? Or will it have a short, in the moment, burst of energy like a roman candle? Being prepared for the former but not surprised by the latter is a prudent course of action in 2008.

LEARN MORE

- *How Will Digital Marketplaces Change the Game in Financial Services?* (Financial Insights, FIN212162 May 2008)

- *U.S. Social Networking Application 2008 – 2012 Forecast: Enterprise Social Networking Takes Hold* (IDC # 211945, May 2008)

- *Mobile Social Networks: Coming to Australia. . .Soon?* (IDC # AU202110Q, March 2008)

- *The Social Enterprise: How Social Networking Changes Everything* (IDC # 210056, December 2007)