



Strategy Lessons from the Credit Crunch

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ComputerWeekly

Published by Computer Weekly on 9th February 2009

The causes of the world economic downturn remind us of some key principles about innovation, regulation and organisation, and what happens if you try to ignore them.

As everyone struggles with the effects of the credit crunch, we need to use the lessons it has already taught us to validate our company's strategy for IT.

Here are three such principles:

- **Innovations are inherently a bit crazy.** This is both their strength and potential risk. To innovate, we need to set aside the existing boundaries. A major cause of the credit crunch was lenders inverting the 1970s innovation that was securitisation of loans. Rather than using securities prudently to lend more money, the new innovation was to lend more money so as to issue more securities. The boundary that the recipient of the loan should be able to pay it back was set aside. Crazy, but true.
- **Regulations and governance help to stop us making mistakes, but cannot always foresee what we are going to do.** How much they can help depends on the extent to which they can predict potential pitfalls. The more that we are innovating, the less the existing rules and processes may notice some of the new, potentially crazy, risks we are taking. If regulation and governance are not tuned-in to the innovations that are happening, as seems to have happened in the credit crunch, by the time they are it may be too late.
- **Organisationally, you can't outsource core competencies - but you can always try.** The management of risk is at the very core of a bank's operating model. Yet we've seen banks try to outsource this competency to someone else. For a while, it seemed to work. But if you outsource a core competency and don't notice in time to bring it back in-house, you can expect things to go wrong.

It looks likely that the regulatory regime for banking will be overhauled. Learning from both the causes and consequences of the mistakes that have been made, the boundaries within which banks can innovate will be narrowed. In particular, it's hard to see how banks will be left as free to outsource the management of risk, nor be allowed to lend money to people beyond what they can prudently be expected to repay.

Meanwhile there are two lessons, in particular, that we can take from the banking crisis to validate our organisation's corporate strategies, including that for IT.

Firstly, while we free people of the normal boundaries to have crazy thoughts, to innovate, our governance processes and rules must equally stay ahead of the game.

Secondly, if our businesses are trying to outsource core IT-related competencies – such as making IT investment decisions, creating value by exploiting IT, and managing IT-related risks - to either external or internal suppliers, then those competencies will come back to bite them one day.

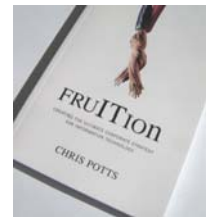
So take the opportunity now to review how your organisation applies key principles for IT-related Innovation, Regulation and Organisation – while the lessons of the credit crunch are still fresh in the mind.



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