

I. Summary of Innovation

Date(s)	Category	Innovation
1975-present	TECH/FINANCE	One of the nation's oldest banks reoriented its business strategy to become the "custodial financial institution" for much of the nation's – and the world's – mutual funds and pensions. In the process they created a new type of financial institution.

Short description

Although State Street spent most of its 213-year history servicing the needs of individual and business customers, it is today a "technology, information, and knowledge company with a bank charter" (Connolly). In the late 1970s and 1980s the company took an innovative turn, altering its business strategy dramatically, and succeeding. State Street is now the #1 servicer of U.S. mutual funds, responsible for more than 40% of the industry's funds. It is also the #1 servicer of U.S. pension funds. It has \$1.4 trillion under management and more than 20,000 employees in 25 countries. It does no retail banking or commercial lending and has no credit card operations; it is a new type of financial institution.

Proposed factors

Rank	Factor	Explanation
4	Leadership/Entrepreneurship	William Egerly was essential in charting State Street's turn towards institutional customers and focusing the company on technology.
3	Inter-regional Rivalry/Competition	The banking climate in the late 1970s and 1980s forced smaller, regional banks to reassess their long-term operating goals. This need prompted Egerly to create a new strategy for State Street.
3	National Market Demand	The business of managing money held in mutual and pension funds was growing increasingly complex in the 1980s, and there was a need for companies that could specialize in this "back office" aspect of the business. Merrill Lynch, of New York City, was a critical early customer.
3	Cluster Collaboration	MFS, Putnam, and to a limited extent Fidelity (all of which were local mutual fund firms) offered support and created a local customer base.

II. Pertinent Background Info

In 2005, State Street Bank had custody of \$9.6 trillion in assets, \$1.4 trillion under management and more than 20,000 employees in 25 countries. This makes it the #1 servicer of U.S. mutual funds, responsible for more than 40% of the industry's funds. It is also the #1 servicer of U.S. pension funds.

For most of its 213-year history, State Street functioned as a regular commercial bank. In 1924 it was named custodian of the first U.S. mutual fund – Mass. Investors Trust, now MFS. State Street's offices were right next door to Mass. Investor's, making the search for an independent custodian a simple affair. Still, this development barely registered in the bank's overall business strategy. In fact, until 1975 the bank's business remained the lending and investment of its customer's money.

In the mid-1970s, State Street had begun to invest in the mutual fund business, driven by the increasing popularity among investors of companies like Fidelity, and also by IBM, from which several key executives had been recruited. In addition, the company had overextended itself by moving in several directions at once and was in the midst of a real estate depression in New England.

Amidst these conditions, CEO William Egerly began moving in a dramatic new direction. Egerly started to redefine the bank's strategic focus to emphasize the servicing of financial assets. By the mid-1980s State Street had transformed from a regional bank to a global financial services provider, a "custodial financial institution." "The corporation has, over the past quarter century, been rethinking, retooling rebranding, and relinquishing many of the traditional activities that comprise its lineage" (Connolly).

In the 1980s, smaller regional banks were under enormous pressure to grow or get "eaten." Boston banks like BankBoston and Baybank got swallowed up, first by larger regional banks, and then by national and international banks. Here Egerly differed from other bankers. Rather than choosing between the two apparent options, he sought a third path. Egerly came from a manufacturing background, and saw the financial world differently than many in banking. Instead of focusing on the acquisition of assets, Egerly looked to earnings per share. And when he looked at State Street's long-running but marginal custodial business, he saw an opportunity. According to then-CEO David Spina, part of the drive for this came from State Street's work with Ned Johnson and Fidelity in the late 1970's and 1980's. Former State Street Senior VP James Darr points out that the Merrill Lynch account, as well as MFS and Putnam (both local firms) were also crucial during this period.

What explains State Street's success? According to analyst Connolly, a willingness to change – to offer core products in new markets and change its identity if necessary. Connolly calls Egerly a visionary CEO who had the foresight to make technology a priority. "Such willingness to innovate and redesign functional priorities and image has kept the company at the leading edge of an evolving industry and contributed to its 24 years of double-digit growth" (Connolly).

Wired magazine had a similar analysis, but as a technology magazine their focus was narrower. They described State Street as the “rare financial asset management company that puts technology first” (*Wired*). State Street’s technology focus has allowed it to develop new products for new markets. In the mid-1980s, when institutional clients wanted to begin investing in international securities, State Street created a multicurrency platform that made it the leading figure in international trade servicing. This early focus on technology resulted in an updated accounting system that positioned State Street to handle complicated international transactions that became more popular among large pension funds in the 1990s.

By the 1990s, State Street was storing data on 10% of all tradable securities processed every day, and began using that data to produce market research and analytical tools to aid in optimizing portfolio performance.

State Street also took advantage of a shift in federal regulations. “Landmark retirement legislation in 1975 created widespread opportunity for mutual funds to be used as investment vehicles within new tax-deferred accounts. Over the next decade, while mutual funds became a household word, State Street was able to leverage its experience servicing that market to an entirely new one: pensions” (Connolly).

Said Darr, “State Street as a custodial institution would not have developed in Dallas or San Diego; it was Boston’s role in establishing trusts in the 19th century and the demand from the Boston-based mutual fund companies in particular which led State Street to be able to shift its mission.”

III. List of Variables

4: Leadership/Entrepreneurship

Several CEOs led State Street’s development and were influential in its business strategy, its hiring of former IBM executives, and its focus on technology.

3: Inter-regional Rivalry/Competition

The banking climate in the late 1970s and 1980s forced smaller, regional banks to reassess their long-term operating goals. This need prompted Edgerly to create a new strategy for State Street.

3: National Market Demand

The business of managing money held in mutual funds and pension funds was growing increasingly complex, and there was a need for companies that could specialize in this “back office” aspect of the business and which had the technical capacity to handle more complex, international trades.

V. Timeline

(from State Street website)

1792 Union Bank founded (the oldest “ancestor” of State Street)

- 1924 State Street Trust Company named custodian of the first U.S. mutual fund
- 1925 Union Bank merges with State Street Trust Company
- 1961 State Street Bank and Trust Company is formed in a merger of Rockland-Atlas National Bank and the Second Bank-State Street Trust Company
- 1970 Opens its first international office, in Munich
- 1975 Begins to focus on the servicing of financial assets
- 1982 Open first office in Asia, in Hong Kong
- 1986 Named largest U.S. master trust custodian by *Pensions and Investments*
- 1991 Assets under custody surpass \$1 trillion, under management reach \$100 billion
- 1997 New brand identity launched, focused on servicing institutional investors
- 1999 Total assets under custody reach \$6 trillion, under management reach \$600 billion
- 2001 Announces 24 continuous years of double-digit operating earnings-per-share growth
- 2003 Completes acquisition of parts of Deutsche Bank's Global Securities Services

VI. Bibliography

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