

>> WHOSE CUSTOMER ARE YOU? THE REALITY OF DIGITAL BANKING IN LATIN AMERICA//

Banking with a social cause

Latin American banks and fintechs are racing to lower costs and access for the unbanked millions.

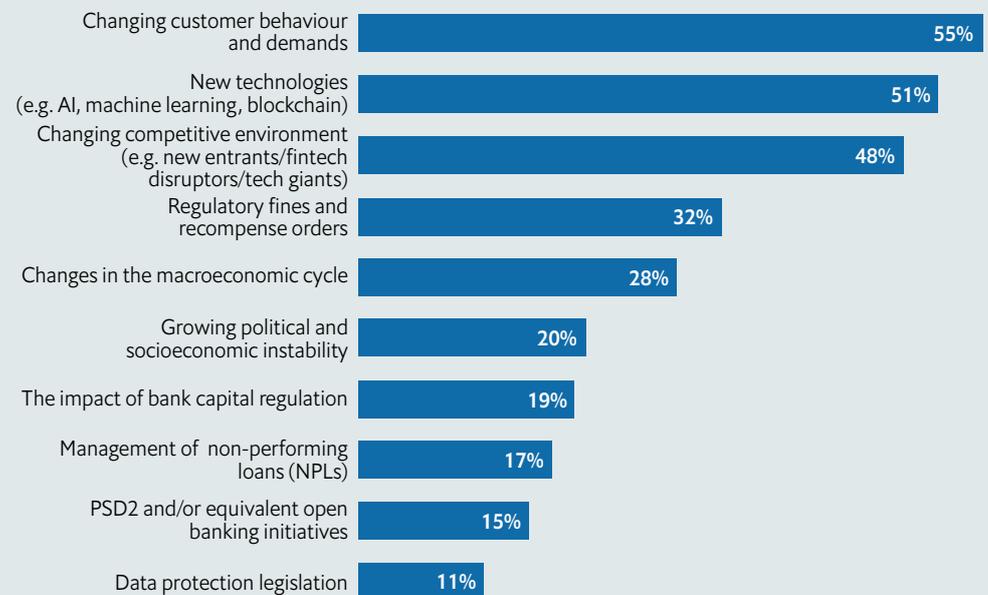
Latin America is fast becoming a hotspot for fintech innovation. Encouraged by progressive legislation, banks and fintechs are collaborating to deliver digital banking to the masses.

Just over half of all Latin American adults now have bank accounts. But credit and debit card ownership and usage lag that in the US and Europe. This has a subsequent effect on e-commerce purchases: 41% of internet shoppers paid cash on delivery last year.¹

Chart 1

Which trends will have the biggest impact on retail banks in your country in the years to 2020?

(% of respondents)



Source: The Economist Intelligence Unit.

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However, an increasingly confident fintech sector that puts simplicity, low cost and social inclusion at the top of the agenda means that digitisation is a tool for improving access and equality in Latin America. Banks have responded by accelerating their digitalisation strategies.

Much of this regional change is being driven by changing customer behaviour and demands—often at a phenomenal pace.

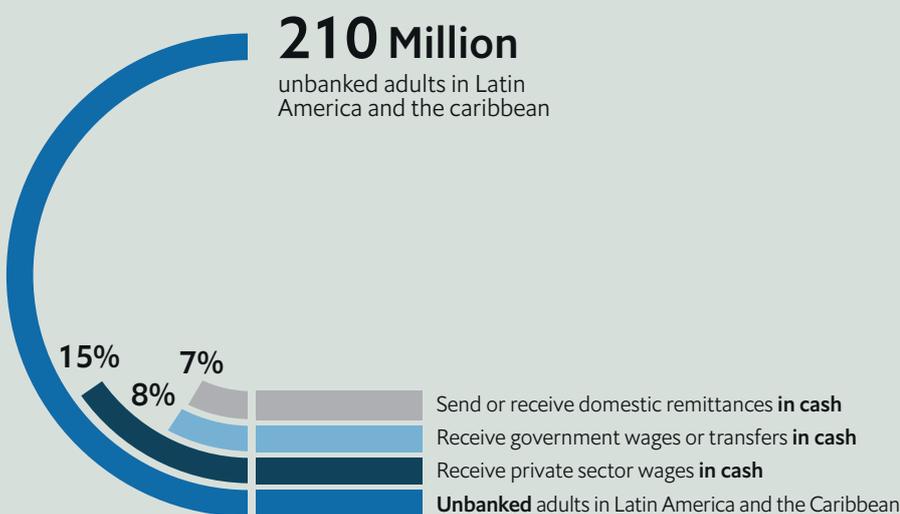
But with over 200m potential new customers also at stake, Latin American banks see a bigger impact coming from new entrants than their peers see in the rest of the world (48% v 36% globally).

However, for the established banks, new payment players are the biggest threat, according to 51% of respondents. This is followed by neo-banks (23%), which offer bank-like transaction services without a full service current account.

Mobile money operators have also taken root in Latin America, with the number of registered accounts growing by 35% in the year to December 2016.² Yet, just 10m mobile money accounts were active at the end of that year, leaving many consumers still without the means to make online, mobile or point-of-sale payments electronically. Accordingly, just 21% of Latin American bankers think that non-financial firms, such as telecommunications or retailers, could become the biggest competition threat by 2020.

THE SHIFT FROM CASH

The World Bank's Global Findex report suggests digital payments will have huge inclusion benefits for Latin America.



Source: The Economist Intelligence Unit.

¹ Global Findex, World Bank 2017
<https://globalfindex.worldbank.org/>

² GSMA Intelligence, The Mobile Economy Latin America and the Caribbean, 2017
<https://www.gsmainelligence.com/research/?file=e14ff2512ee244415366a89471bcd3e1&download>

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Digital payments in the past year (% age 15+)

Made or received digital payments	45.1
Made or received digital payments, 2014	37.7
Used an account to pay utility bills	14.0
Used an account to receive private sector wages	12.6
Used an account to receive government payments	15.9
Used the internet to pay bills or to buy something online	14.9
Used a mobile phone or the internet to access an account	11.1
Used a debit or credit card to make a purchase	27.6

Source: Global Findex, World Bank, 2014, 2017

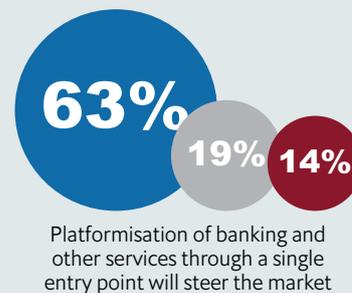
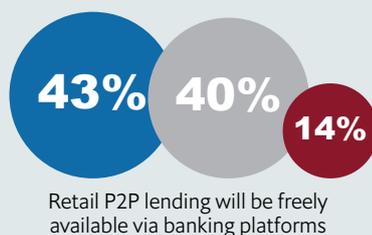
The regulatory push

Bankers in the region are more likely to believe that customers will forgo human contact for cheap or free services (68% v 56% of global respondents). They also firmly believe that cashless payments will be prevalent by 2020, with 69% of respondents agreeing to this statement (see Chart 2).

Chart 2

Do you agree/disagree with the following statements? By 2020.....
(% of respondents)

● Agree ● Disagree ● No opinion



Source: The Economist Intelligence Unit.

Well-planned regulation is helping drive them towards that goal. Digital banking makes a lot of sense to Latin American regulators who champion financial inclusion.

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Bolivia was first to introduce mobile money regulation in 2011, followed by Peru, Brazil and others.

Mexico's new fintech law aims to level the playing field between dominant banks and new fintech players. Drawing newcomers into the regulatory framework should encourage consumers to try new services in the knowledge their money is protected. Carlos Orta Tejada, vice-president for regulatory policy at the Comisión Nacional Bancaria y de Valores, says new information requirements are on their way to ensure third-parties accessing open banking have the highest levels of security.

Other regulatory drivers are also at work. Chile, Mexico and Brazil lead the world in requiring government and business contracts to be completed through electronic invoicing. Now covering virtually all product shipments and services sales, e-invoicing has increased Mexico's tax revenue by a third without the need to raise tax rates, according to Billentis,³ a billing software provider.

E-invoicing has also created a boom in digital factoring services and business management software offers designed to ease businesses into a full digital banking experience. Digitising business transactions also helps to build credit profiles for many of the regions small and medium-sized businesses (SMEs). SME lending is an area that 17% of survey respondents see as the sector where most new entrants will gain market share in the next three years.

Low-cost, not unprofitable

As they adapt to this new environment, banks have to rethink how they build and manage their new products. Improving product agility and time-to-market is very important, as cited by 49% of respondents as a strategic priority. However, it is not the leading priority for Latin American banks.

However, in an increasingly digital world where customers want cheap access, Latin American bankers remain more focused on cutting costs and improving margins, with 51% of respondents citing this as their top strategic priority.

Chart 3

What are the top strategic priorities for your company in the years to 2020?

(% of respondents)



Source: The Economist Intelligence Unit.

³ E-invoicing/E-billing, Bruno Koch, Billentis, 18th May 2017, https://www.billentis.com/index_e.htm

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That may seem odd in a market that is infamous for the cost of credit. Brazilians pay in excess of 300% interest per year for overdrafts, while rotating credit card rates still hover above 200%.⁴ However, banks insist those hefty rates are not price gauging, but are necessary as regulations require them to provision heavily against non-payers and chargeback claims on card purchases.

With regulators also pushing banks to offer lower-cost lines,⁵ banks are deploying new technologies to cut operational costs. They are investing in new risk profiling and vetting procedures, and financial budgeting tools, to help customers keep their finances in order and to keep costs and non-performing debt levels down.

NEW LOOK, LOWER COST

For customers of Mexico's Banregio, the future is orange.

Regional bank Banregio recently revealed the first results of Proyecto Naranja (Project Orange), with a new logo and branding for its 150 branches.

There is also more fundamental change under way. The group is busy adopting new technologies to simplify products and cut costs.

The bank is already one of Mexico's most profitable, with a return on average equity of around 20% and a respectable 42.4% efficiency ratio. But to sustain its growing SME lending lines, the bank must also expand the deposit base.

Proyecto Naranja is targeted squarely at the mass

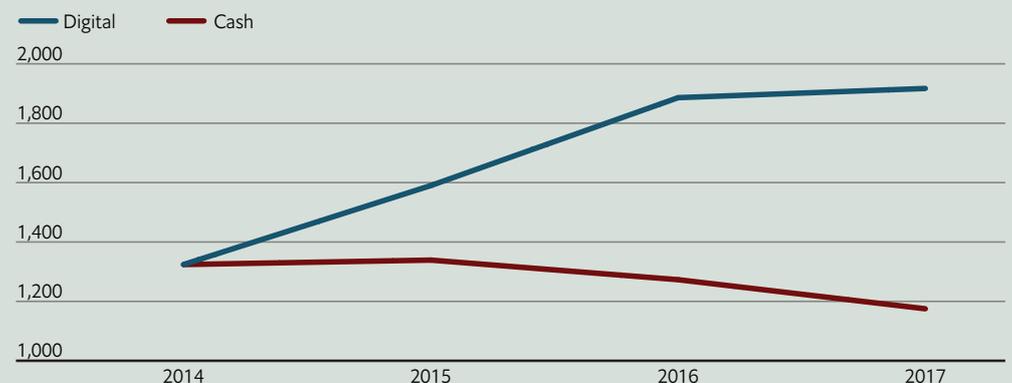
affluent retail sector, using digital channels to attract new savers and investors to easy-to-use and low-cost products.

The Tarjeta Más credit card has done away with annual fees. Card users also get cash rewards, without having to buy other financial products as part of a bundle. Investment products have been re-engineered to ensure customers get good returns for the life of their holdings, not just during introductory offers.

Customers are also taking the hint on digital. Cash transactions continue to fall, which should help support margins and the bottom line. In 2017 digital transactions almost outstripped cash payments by two to one.

Banregio's digital transactions take-off

(millions of transactions)



Source: Banregio, March 2018.

⁴ Associação Brasileira das Empresas de Cartões de Crédito e Serviços, March 13th 2018, <http://www.abecs.org.br/app/webroot/files/media/2/f/8/279232d35c46a9e1e1d98d4a5eafa.pdf>

⁵ Reuters, Brazilian banks will offer alternatives to overdraft credit, April 10th 2018, <https://www.reuters.com/article/banks-regulation-spreads/brazilian-banks-will-offer-alternatives-to-overdraft-credit-idUSL1N1RN1IV>

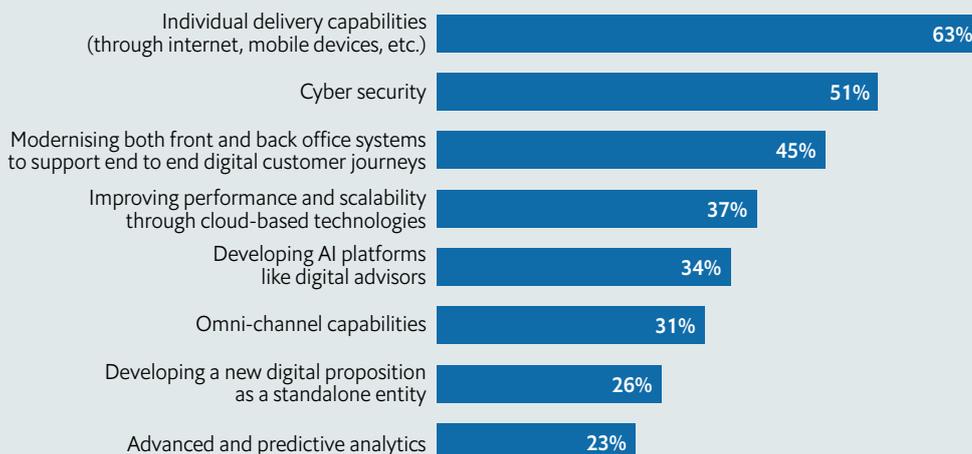
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Chart 4

Where is your company focussing its digital investment?

(% of respondents)



Source: The Economist Intelligence Unit.

In this low-cost shift, banks are focusing their digital investment more heavily on individual distribution channels (cited by 63% of respondents) or on modernising both front and back office systems to support end-to-end digital customer journeys digital-only standalone operations (45%).

Banks in Latin America believe that artificial intelligence (AI) will offer a range of valuable options. For 29% of respondents it will be an important strand in developing a strong, personalised customer experience, while 22% think it will be most valuable in automating on-boarding to maintain margins and profitability.

In Chile and Central America, Bancolombia is busy deploying AI and chatbots. Customers can even check their balance on Facebook in real-time. Chief executive Juan Carlos Mora Uribe has dedicated a further US\$140m to continue the digital transformation⁶ that has already seen 80% of the bank's transactions switch to digital channels.⁷

Focused on innovation

Latin American bankers have ambitious goals and a lot to achieve as they race to lead digital banking. They must revitalise their offering, cut prices and improve access. They also have to attract a lot of new customers who have never banked before or are wary of getting caught by high rates, charges and debts.

To meet these challenges banks are rethinking their innovation strategies. Bigger banks can afford in-house development teams; 51% of survey respondents cited setting up an in-house innovation centre as their innovation policy. Big banks also have the clout to attract fintechs to work for them on an exclusive basis. BBVA and Santander, both large regional players, have bought some fintechs outright. Survey respondents think in-house accelerator programmes (48%) and closed bank hub initiatives (48%) are the best way to encourage innovation. However, others, particularly smaller competitors, are looking to collaborate by focusing their innovation strategy on open bank hub initiatives (46%). If Latin America is to fully embrace online and mobile digital banking, collaboration and a level playing field will be necessary.

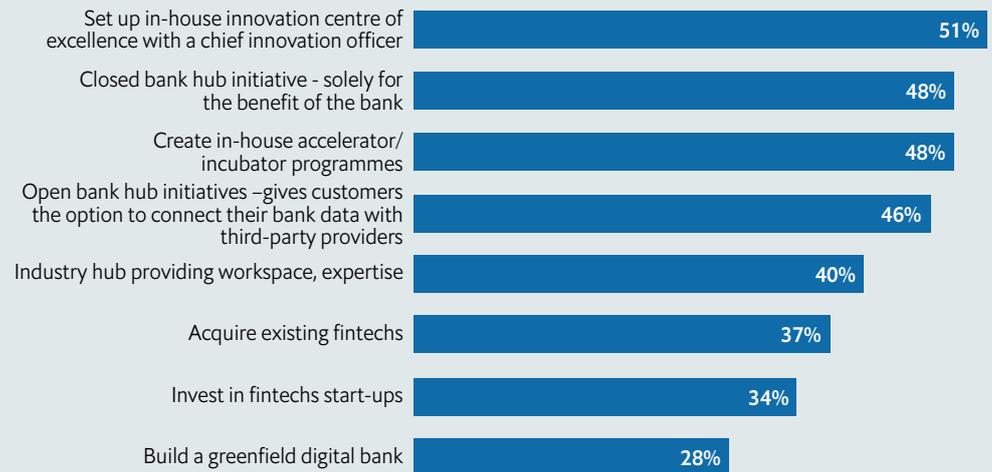
⁶ Finance Colombia, Bancolombia to Invest \$140 million in Digital Transformation This Year, March 16th 2018, <https://www.financacolombia.com/bancolombia-to-invest-140-million-usd-in-digital-transformation-this-year/>

⁷ Grupo Bancolombia, February 21st 2018 <https://www.grupobancolombia.com/wps/portal/acerca-de/sala-prensa/todos-los-articulos/resultados-financieros/grupo-bancolombia-supero-los-160-billones-de-pesos-en-cartera-en-2017>

Chart 5

What is your bank's innovation strategy?

(% of respondents)



Source: The Economist Intelligence Unit.

WHEN THE CUSTOMER RUNS FASTER THAN YOU

Itaú Unibanco

Big Brazilian banks have rushed to keep up with changes in consumer behaviour.

Ricardo Guerra, head of IT at Itaú Unibanco, jokes that everyone in São Paulo always arrived late for meetings because the traffic is so bad. Thanks to the Wave traffic app, they now turn up on time—or even early. It is a culture shock.

A revolution has hit customers' communications too.

"WhatsApp gained 130m users in Brazil very fast. Now customers demand to use the app to a call centre. When the customer runs faster than you in digitalisation, businesses face challenges," says Mr Guerra.

Facilitating online instant replies and easy authorisation processes means adapting thousands of processes and the internal culture. Decisions must be faster, focusing on solving customer issues and to reduce attrition.

"We were not slow at understanding; we had cellphone banking back in 2008. But incumbents have to develop solutions at scale," Mr Guerra says.

Itaú Unibanco has now caught up. It too can update its mobile phone app 60 times a year if necessary.

In IT alone, restructuring for agility involved 7,000 staff and took three years. Training is still ongoing.

Micro-services and the cloud let the bank test a hypothesis and solution without breaking the rest of the bank's system. Artificial intelligence is important for agility, costs and faster customer outcomes. Mr Guerra also sees a role for blockchain, but not yet.

"Blockchain will eventually allow entities to interact in different and more efficient ways but not affect the customer business itself," he says.

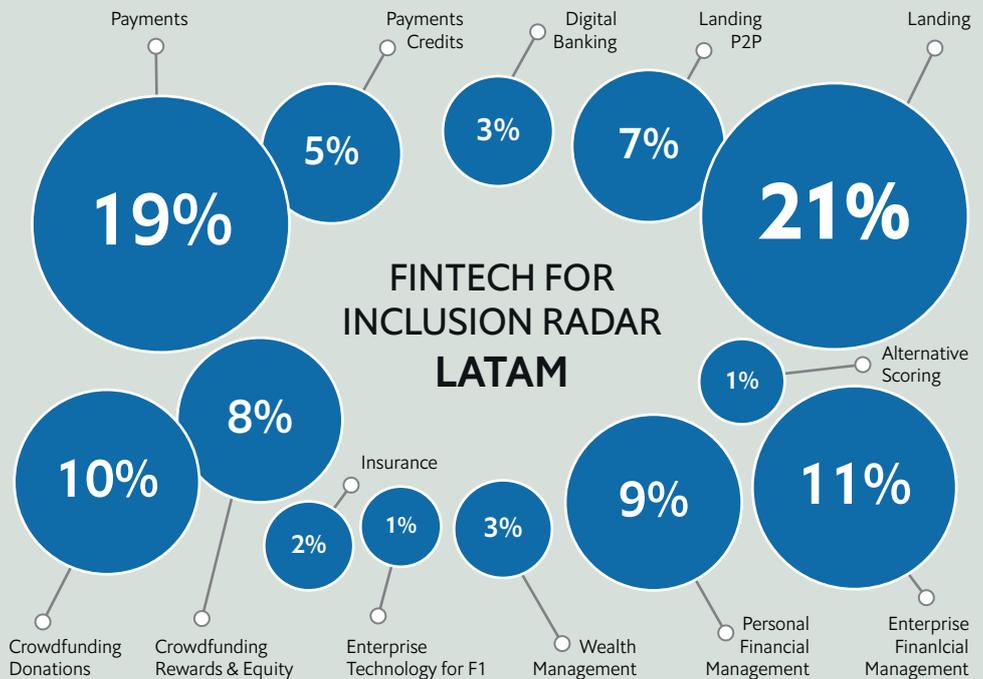
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FINTECHS BANK ON INCLUSION TOO

Finnovista calculates that 40% of fintechs in Argentina, Brazil, Chile, Colombia and Mexico are targeting unbanked and underbanked consumers and small businesses.

Lending and person-to-person (P2P) lending comprise the largest sector, followed by payments and crypto-payments. Just 3% of the fintech universe is challenging the incumbents with digital banking offers.



Source: The Economist Intelligence Unit.