

Improving operations and IT in Latin America's banks

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To go on growing, these institutions must raise their productivity by streamlining the back office.

Retail banks across Latin America have increased their revenues without increasing their cost-to-income ratios—the result, among other things, of generous spreads between the banks' average borrowing and lending rates and of a greater uptake of banking services by the region's middle-class population. But some of these factors may prove difficult to sustain as Latin America's financial markets mature. Our research¹ suggests that to continue this strong growth, the region's banks must raise their productivity by streamlining back-office operations, reducing channel costs, and capturing more value from IT investments.

Centralizing back-office operations (such as processing checks or opening and closing accounts) offers the greatest opportunity for savings. The performance of the banks we surveyed varied widely; the worst performers spent nearly six times more per transaction on their back-office operations than did the leaders. However, we found no correlation between centralization in IT and operations, on the one hand, and cost leadership, on the other, mainly because many banks in our sample created central offices yet were reluctant to reduce staff levels or infrastructure expenses in branches.

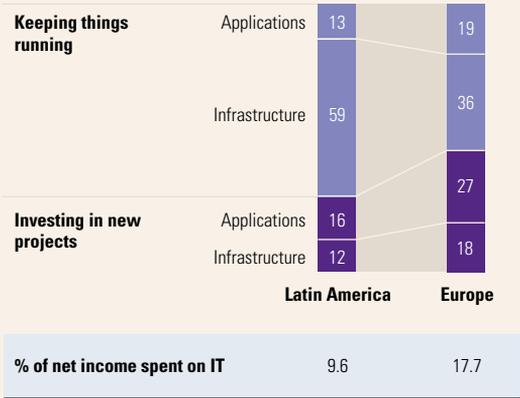
Nevertheless, top performers, whatever their level of centralization, did a better job at clearly delineating the responsibilities of the branches and the central office. They also made better use of technology to reduce unnecessary errors or rework—for example, by deploying work-flow-management software to help managers track activities (such as the processing of checks or credit applications) and to spot bottlenecks and thus ensure consistent service. To maximize the productivity of back-office personnel across branches, the leaders created consistent processes (such as lists of documents that must be checked before opening an account) that reduced variability and errors while cutting costs. Top banks also worked closely with their IT vendors to make sure they got the most from the available technology and rigorously monitored the performance of their employees by using incentives and penalties to ensure accountability.

Channel operations are the second opportunity for improvement—something that our experience also shows to be true of banks in other emerging markets. For the Latin American banks we studied, staffing levels were relatively elevated because of a high volume of costly paper-based transactions and the large proportion

EXHIBIT

Where does the money go?

Average distribution of banks' total IT costs, 2005,¹ %



¹ Latest available data; in Latin America, total cost = operating expenses + depreciation; in Europe, total cost = operating expenses + capital expenditures.

Source: 2006 Excellence in Technology Operations (ETO) study conducted by McKinsey and 19 banks in Argentina, Brazil, Chile, Colombia, Mexico, Peru, and Venezuela; 2005 McKinsey survey of IT costs in 37 European banks

of low-income consumers who use branches rather than alternative channels. (Often these consumers have no accounts with a bank and use branches only for activities such as cashing checks or paying bills.)

Still, top performers had channel costs per customer that were up to 42 percent lower than those of the average bank. They tried to keep their teller-to-customer ratios as low as possible while encouraging customers to move transactions to other channels—by using education and incentives to spur ATM usage, for example. Indeed, some banks have managed to migrate 68 percent of their transactions to alternative channels over several years. Moreover, the tellers of the top banks were highly productive, conducting up to 250 financial transactions a day, compared with only around 100 for tellers at some poorly performing banks. The leaders achieved these numbers by optimizing

processes and using technology where possible—for example, confirming a client's identity by scanning a debit card rather than visually validating a physical signature.

Banks in the region should also look for ways to get more from what they spend on information systems and IT infrastructure. The Latin American banks in our sample devote, on average, about 10 percent of their net income to IT, compared with almost 18 percent in Europe. Latin America's lower labor costs for application development explain much of the difference. But what the region's banks did spend was more likely to go toward keeping current systems running and up to date rather than to finance new projects that might generate revenues and growth (exhibit).

In fact, only one-quarter of the Latin American banks in our sample devoted more than 30 percent of their total IT spending to new projects. In our experience, some European banks commit up to 60 percent of their IT investments² to such undertakings.³ Latin American banks that approach such levels of investment do so by taking advantage of scale—for example, consolidating data centers and standardizing equipment.

Once these measures begin to free up funds for new projects, Latin American banks should set up committees to approve IT investments in order to avoid wasting money on projects that have no value for the business. In our experience, such committees play an important role in enforcing fiscal discipline.

Latin America's banks are more and more willing to use industry benchmarks and objective financial metrics to guide and prioritize their IT investments. Some are incorporating these measures into their strategic-planning and budgeting exercises

(for example, in setting performance targets). The resulting wider and more open discussion between chief information officers and chief operating officers promises to foster a culture of ongoing operational-performance improvements.

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¹ In 2006 McKinsey and 19 banks in Argentina, Brazil, Chile, Colombia, Mexico, Peru, and Venezuela cooperated in the second annual Excellence in Technology Operations (ETO) study, an effort to provide comprehensive benchmarking data on retail-banking operations across Latin America. In each area of operations that we studied, our benchmarks identified leaders, and we then examined their practices to see what they did differently. The study included both a quantitative comparison of the banks' performance on key indicators (such as channel costs) and a qualitative assessment of operating practices.

² Equivalent to 35 percent of the IT investments of Latin America's banks, given their lower labor costs.

³ For more on channeling investment to innovation, see David Craig and Ranjit Tinaikar, "Divide and conquer: Rethinking IT strategy," *The McKinsey Quarterly*, Web exclusive, August 2006.