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To Be Or Not To Be Digital, is that the question?

How the Latin American Financial Industry should tackle the issue

Financial Services Industry

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The Problem

Innovation in Latin America is an unresolved issue, and an area where there is still much to be done. Financial Services are not alien to this scenario but part of it. Concepts such as Internet of Things (IoT), digitalization, mobility, and ecosystem explain what is happening with innovation in the world.
But what is happening with the financial system in Latin America in connection to this?
A market with over 500 banks, operating in a region of over 600 million inhabitants and a GDP of over $5.5 bn cannot lag behind. Therefore, the problem is how to tackle the challenges that this problem generates.

The Analysis

The process of innovation that brought us the "digital era" has also leveraged mobility, which has affected the quintessential banking center, the branch. It also generated the emergence of new players, "fintechs", which were able to take advantage of technological advances in order to create products and financial services which are simpler and easier to use. Along that line, the future of financial services will be in the simplification and automation of operations, the decrease of intermediation, and a strong strategic role of information that will be useful for the creation of ever more targeted niches. This is why being digital is not a question but an imperative if one wants to lead the future, or just survive.

Take Away

The problem discussed leaves us some food for thought:

- Innovation is deliberate and predictable. There is no turning back, it is here to stay.
- Connectivity creates opportunities but requires something crucial: the transformation of the model of the financial industry.
- Ecosystems can help to achieve this through a work philosophy based on competitive collaboration (win-win).
- The "digital journey" entails great challenges; this is why it is necessary to be supported by three main pillars if we want our journey to be successful: Strategy, Culture, and Leadership
- Successful transformations do not happen overnight, the challenge is to create a new reality that can change what clients perceive and experiment.

Introduction

Lately, much has been said, and even more written, on different subjects that affect not only the Financial Industry in general but also our ordinary behavior. Innovation, Internet-of-things, Digital, Mobile, and Ecosystem are just some of the ideas we hear and read daily. These ideas intend to help us make sense of the time we're living in, and where we're headed.
The innovation process that has brought about the digital revolution is here to stay: the figures bear this out. Nevertheless, this process has yet to happen in Latin America. The 2014 Global Innovation Index (1) shows Latin America with a very low average score, of just 32.85, barely above the one for Central and South Asia and Sub-Saharan Africa. It is far from the scores for North America (58.1), Europe (47.23), and South East Asia and Oceania (41.72), just to name a few examples. Without a doubt, governments can help foster innovation processes, but the private sector should also encourage it. The institutions in which these processes are standardized treat them like any other core process in their business model.

Another benchmark widely used currently is the ratio of electronic devices to inhabitants (e.g. 1.5 for Argentina, according to official statistics) of the country where the devices have been sold. **In this case, there's more devices than inhabitants**

Another benchmark widely used currently is the ratio of electronic devices (cell phones, tablets, etc) to inhabitants (e.g. 1.5 for Argentina, according to official statistics) of the country where the devices have been sold. In this case, there's more devices than inhabitants. Another example is that in Latin America between 1% and 3% of lines and cell phones (some 12 million) work with 4G technology. This is very little compared to the 500 million which do globally (2). In the next five years, it is estimated that Latin America will go from a total of 750 million mobile phone lines (this includes 3 and 4G) to 850 million in 2019. However, 4G lines will grow by nearly 1,000% (from 28 to almost 200 million) (3).

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This is a clear indicator of the room for growth that there is ahead. Even more so if we take into account that "wearable technologies" (ie, clothing and accessories incorporating electronic technologies) are also growing, and many people already consider their smart phones as wearable.

This process of transformation driven by innovation is going strong in developed financial markets such as the US and some European countries. But what is happening in Latin America's financial sector? A market with almost 500 banks, which operate in a region of over 600 million people, and a GDP of over $5.5 bn, should not be left aside. Potential positive side effects of this transformation process could generate a sustainable impact in the region, if this sector emerges as a truly competitive one within the Global Financial Services industry.

With this landscape in mind, we will try to establish our outlook in order to show how closely connected the previously mentioned issues are; how they impact the transformation of the financial services sector, and especially how the Latin American bank sector can face the challenges it will face in this new scenario.

(1) "The Global Innovation Index 2014: The Human Factor in Innovation" - Cornell University, INSEAD, and the World Intellectual Property Organization (WIPO).

(2) Data from Telecom Signals Consulting, published in Latin Trade magazine, May/June 2015 issue, p. 18.

(3) Data from 4G Americas Consulting, published in Latin Trade magazine, May/June 2015 issue, p. 18.

Innovation

We know that innovation is inherent to the human condition since the dawn of man. Innovation is a very powerful positive process which can be learned, planted, and even bought. Generally, in the business world, it is generally translated as obtaining a competitive advantage. We will surely find many definitions of "innovation", some of them even contradictory, and worse still, they do not generally refer to innovation as a sociological phenomenon when it actually is, and even more so nowadays. Innovation is necessary for any industry or sector so that its long-term existence is assured, and the Financial Industry is no exception.

Human beings have the expectation that the products and services we consume will be improve in time; this is directly related to the degree of satisfaction and usefulness that we experience. These feelings will be diminished by lack of innovation in the good or service. Nevertheless, and as we have just seen, in Latin America we still have a long way to go.

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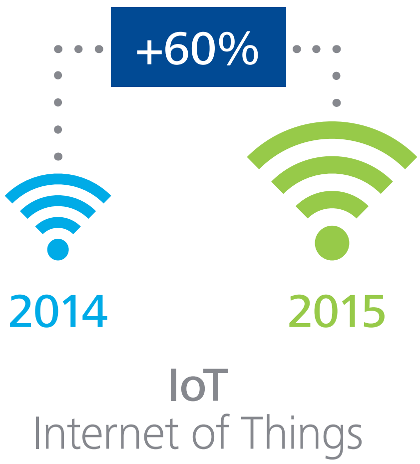
Internet of Things

One of the most recent innovations is in the field of Internet, and is called Internet of Things (IoT). According to a Deloitte study, one billion IoT devices will be in the market in 2015 (a 60% increase from 2014), and 60% of all existing devices (around 2.8 bn) will be bought and used by companies and industries. 90% of all the income generated by the use of these devices will be generated by companies of different industries (4).



> Connectivity creates opportunities but it also requires something crucial: the transformation of business models

Connectivity creates opportunities and it also requires something essential: the transformation of business models. The Financial Industry is not (nor it will be) alien to this process. It also creates risk, which forces institutions to develop security platforms which are reliable for users. That is to say, this is a multi-faceted challenge.

In Financial Services we have not yet seen the emergence of massive use of IoT, although it could have many valuable applications in fields such as the design of products (eg leasing) which will have different standards from the ones currently used, and can be measured in real time. Also, risk management and contracts (eg warranties) using smart analytic information through devices which are both connected to one another, and to the central system. Let's leave the concept of innovation aside for a moment, and move on o the concept of digital.

(4) "The Internet of Things really is things, not people". Deloitte Research 2015.

Digital

To think about digitalization is to think firstly about technology. It could be said that this is maybe the best example of recent technological innovation. However, and as we will see below, strategy and culture are two main pillars of this new "Digital Age", which is here to stay. The strength of the digital revolution does not reside in the different shapes it takes through technology, but how institutions can use those technological tools to transform their business models. The banking sector is not alien to this transformation. To talk about transforming a business is to talk about strategy. The digital age has changed, and is changing, several ideas, among them leadership styles. Here the third pillar appears.
The needs of both clients and institutions evolve to the pace of digital technologies. This is a profound cultural shift that the latter need to know how to address.

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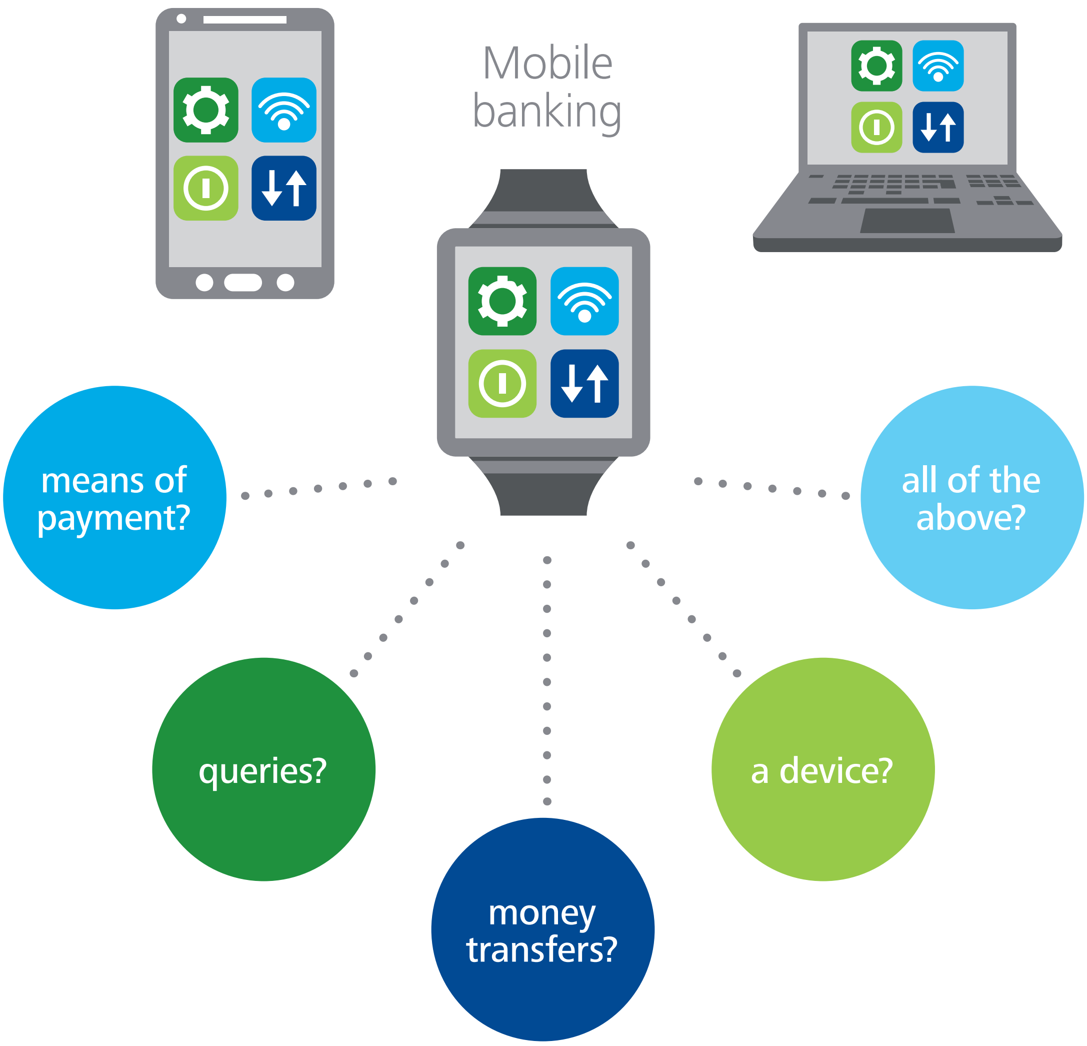
Mobile

At this juncture we can say that the innovation that brought about digitalization also leveraged mobility (there are myriad examples of this in the banking sector). This has brought on a virtuous cycle whose outcome is more innovation. The issue here is to agree on what we understand by mobile banking (means of payment? queries? money transfers? a device? all of the above?) Maybe this isn't completely clear in Latin America. Mobility brings another issue to the table, and is about the future of banking in general and of branches in particular. This takes us back to what we were discussing before: the process of transformation underway which is transforming banking with technological innovations which are here to cater to clients' needs. So we will revisit the three pillars of any evolutionary process of transformation: Strategy, Leadership, and Culture Maybe by analyzing them we will be able to answer the question in the title.



Ecosystem

Until this point we have discussed innovation, IoT, digitalization, and mobility among other issued leveraged on technology, and as we can plainly see all of them involve different players, internal and external to institutions. This is the point where we have to bring in another relatively new concept, the one of "ecosystem", which might be understood at a high level but it is still complicated to apply it correctly in practice.

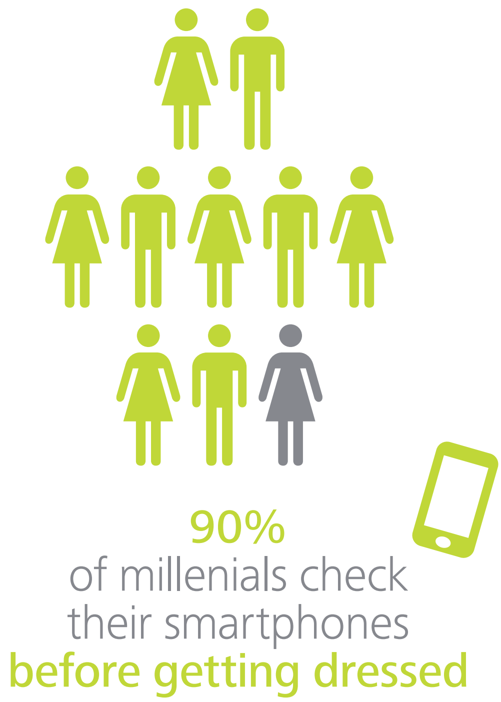
Talking about ecosystems makes sense when we talk about nature, but not when we talk about business. An ecosystem may be defined as "*a dynamic, co-evolutionary community of diverse actors, who create and capture value through a sophisticated model of collaboration and competition*." (5)

In that direction, "an organization must not be seen as the sole member of an industry or sector, but as part of a business ecosystem which is part of a community of industries or sectors." "*In a business ecosystem the members will work in competition and cooperation to develop new products to satisfy the needs of consumers and eventually include the next evolution of innovation*." (5) This is a key issue that will support our point of view.

The underlying philosophy of the ecosystem will provide a paradigm shift which pursues a deep change in the economy and in the business outlook. The importance of relationships, associations, networks, alliances, and collaborations, is not new but it is crucial. This allows organizations to implement and use assets that are not necessarily of their property, or even their total control, in order to commit and mobilize a greater number of participants, coordinating and sharing experiences and activities.

An example which has come out strong during the last decade and which shows the intimate relationship between innovation and ecosystem is the emergence of companies which develop technology applied to the financial industry. They are commonly called "fintechs". These new companies, called startups, have been faster than banks in taking advantage of the advances of digital technology, and they have developed banking products that are more efficient and easy to use.

The movement of "fintechs" initially created some



mild disruptions for the financial industries. They were mainly related to means of payment, peer-to-peer credits, and personal financial advisory. However, the constant advance of technology, the changes in clients' preferences, especially the greater involvement of millenials (90% of them check their smartphones before getting dressed), and ever-growing investment have been the basis for a larger-scale disruption, which has a direct impact on the chain of value. A wide range of new suppliers has appeared, with the ability of building value offerings that satisfy the needs of "digital clients" in an easier and more economical way.

After a slow start, Latin American "fintechs" are developing at a steady pace. However, their global effect in the financial industry has been mild, although they are still making fundamental changes to its infrastructure and central processes. On the one hand, banks have some relative disadvantages. For instance: being regulated often acts as a heavy load, although it helps to build trust with the consumer (especially in a crisis.) On the other, it is true that they also have advantages. Banks understand the financial business, and especially the risks it entails, whereas the new players sometimes cannot see them in all their scale. The fact of having strengths and weaknesses on

(5) "Business ecosystems come of age". Deloitte University Press 2015.

one side and on the other means that working more in collaboration than in competition, taking advantage of the synergies that can happen, will make it easier to achieve success, that is to say, catering to the clients' needs. For example, while startups have the know-how of innovation, banks can offer scale and critical mass through rapid access to demand. Here we have the cornerstone of value that an ecosystem can provide: competitive collaboration. This expression might appear to be an oxymoron but the idea can create a deep transformation though a business model in which all players (banks, startups, and clients) win.

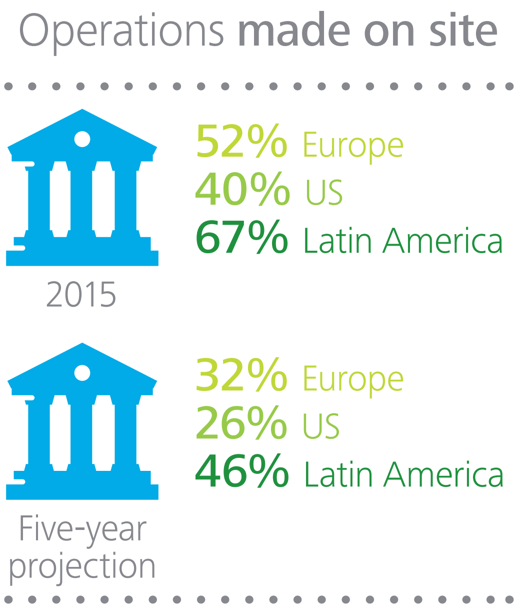
The digital path for financial institutions continues, but with new actors with which work must be done in collaboration and competition (win-win), through an ecosystem that allows them to reach their goals. Each side has the strengths the other one lacks; the combination of both will produce a truly transformational synergy.

We have seen how the so-called digital revolution is transforming the business model of finance, and one of the main points of impact is channels, and among them, the most relevant one is the network of branches. Much has been talked (and surely, will be talked) about branchless banking. But is this really possible in our region? Let us see.

While startups have the "know-how" of innovation, banks can offer scale and critical mass through quick access to demand. Here we have the cornerstone of value that an ecosystem can provide: competitive collaboration. This expression might appear to be an oxymoron but the idea can create a deep transformation though a business model in which all players win

Impact of digital innovation on bank branches

A seamless client experience through every channel, physical and digital, is a hot issue for Latin American banks, and many are understandably worried about this. Branches are watching a lower volume of transactions made on-site, because clients migrate more and more to digital channels. According to a survey written by The Economist Intelligence Unit, the percentage of operations made on site in Europe is 52%, in the US 40%, and in Latin America 67%. The same indicators, with a five-year projection, show values of 32%, 26%, and 46% respectively (6).



Nevertheless, and especially in our region, they have a lot going for them:

- **They are the natural face-to-face interaction with clients**, which facilitates building trust, and therefore loyalty. In the same way, they are key in branding: they represent the institution's capacities and culture.
- **They are an important channel of inclusion.** A branch location is still the main reason why clients choose to concentrate their financial activity in them.

In the new scenario for the Financial Industry sector, client experience is underway to become the backbone of a successful, competitive outfit. To achieve an outstanding client experience Latin American banks need to clearly understand their needs and expectations, so that they can later make the right decisions of investment regarding technology, processes, and talent. How branches adapt to local needs (be they regional or communal), the empowerment of staff who is in contact with clients, and the implementation of new platforms to manage client service are just a few of the actions to be taken to achieve these goals.

We are already seeing how many institutions around the world have started this journey opening flagship branches as prototypes even when they haven't always paid attention to local needs. However, changing the designs and structures of offices and implementing new digital tools is not enough. It is only a change in style if it's not complemented by other measures (as important or more so) such as staff training, and having product packages suited to local needs. This is a lesson learned that Latin American banking needs to watch carefully.

Supposedly, a model of uniform branch throughout a network would be the most convenient way to deliver consistent client experience. However, this outlook does not take into account the different needs, preferences, and expectations of clients. There are two cultural traits in our region that often could be contradictory: one is the great diversity between countries, and in turn within each country between different regions. And the other is that this local quality often exacerbates this diversity and turns it into a barrier when one attempts to provide a uniform service. The main problem that digitalization brings about in our region is the decrease of face-to-face interactions with the client, and this is a central issue in our Latin culture.

(6) Economist Intelligence Unit survey, September 2014. How mobile is transforming retail banking Redefining banking to survive and thrive in a digital world.

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This makes us conclude, firstly, that there is no unique and ideal client experience in the branch. When decisions related to location, design, services, availability of information, and staffing are taken with the local market in mind, they can improve performance and be crucial for achieving our goals. Nevertheless, there are two hurdles in this ideal path. Firstly, most banks work as silos, or as if they were several banks within the same outfit. Second, and most important, the infrastructure of obsolete data management, and ill-defined processes are inhibitors for the timely exchange of information between different business units and with the staff that interacts with clients. Having a single comprehensive vision of the client in all channels has become a crucial goal of banks, and must be at the top of any agenda, because it is only this type of branch that will be efficient to attract and retain truly profitable clients. Is there a simple, secure way to achieve this? Clearly not, but a key component is human interaction; because when technology fails this is what can help the client have a positive and consistent experience. Bad service is the main reason quoted by clients when they discuss why they changed banks. To be able to solve all the client's complaints in one step is probably impossible for any bank. However, staff training and empowerment in branches allows banks to move towards that goal. Nowhere is this more relevant than in Latin American bank branches, for reasons previously discussed.

The Future of Financial Services

The landscape we have seen so far makes us wonder: what is the future of the financial industry? According to the report "The Future of Financial Services" (7) written by the World Economic Forum, in collaboration with Deloitte, there are so far three main issues that are not well understood, and they deal with how disruptive innovation impact in the financial industry.

1. There is no common taxonomy or understanding of **which innovations** are the most relevant.

2. There is no clear understanding of the **evolutionary path** of emerging innovations.

3. The **implications of those evolutions on incumbent business models** are unclear, creating significant uncertainty for traditional players as they strive to react to growing competitive pressures.

(7) "The Future of Financial Services – How disruptive innovations are reshaping the way financial services are structured, provisioned and consumed". An Industry Project of the Financial Services Community prepared in collaboration with Deloitte. Final Report, June 2015.

In the same way, the survey synthesised six high level insights on innovation in financial services:

- It is deliberate and predictable; incumbent players are most likely to be attacked.
- It is having the greatest impact where they employ business models that are platform based, data intensive, and capital light.
- The most imminent effects of disruption will be felt in the banking sector; however, the greatest impact of disruption is likely to be felt in the insurance sector.
- Incumbent institutions will employ parallel strategies; aggressively competing with new entrants while also leveraging legacy assets to provide those same new entrants with infrastructure and access to services.
- Collaboration between regulators, incumbents and new entrants will be required to understand how new innovations alter the risk profile of the industry – positively and negatively.
- Disruption will not be a one-time event, rather a continuous pressure to innovate that will shape customer behaviours, business models, and the long-term structure of the financial services industry.

According to this report, the future vision of the industry as a whole is determined by the simplification of infrastructures (improvements in connectivity); automation of high-value activities (to offer alternative products and services which are cheaper and scalable); the reduction of intermediation (because of the streamlining of products and services offered); the strategic role of information (a new dataset which will allow us to understand clients' needs); the origination of niches and specialized products (creating highly targeted products and services); and lastly the empowering of the client (offering greater visibility in products and control over existing operations, which will make the client be a proactive consumer.)

This being the future scenario of banking, the question we asked before becomes even more important.

To be or not to be digital,

is that the question?

We will try to provide some ideas which could get us closer to an answer.

Throughout this development we have discussed how disruptive innovation through technology produced the so-called "digital age", which in turn allowed us to perform most of our daily pursuits anywhere and anytime, originating mobility. This "digital mobility", in particular, influenced the quintessential banking channel , the branch, which brought awareness to the dire necessity to produce the necessary transformations which would help reach the clients' expectations by satisfying their needs.

We have also seen how this process of innovation has been promoted, to a great extent, to the "fintech" movement and its many startups, which keep creating new ways of doing things every day. This has led us to propose the idea of working through ecosystems as the new mature way of doing business in this new era. We have also seen how the future of banking in general is conditioned by the ability and capacity of its players (regulators and regulated) of rethinking and transforming their business models so that the whole industry can work better.

According to a survey written by MIT Sloan Management Review and Deloitte (8), one of the main findings has been that the foundations of the digital revolution are not individual technological tools but how organizations integrate them in order to transform their business models, and how they work after this has been done. Another key finding is that what makes a leading institution stand out form the rest is a clear digital strategy combined with a culture of collaboration which fosters risk-taking, and a solid leadership to steer the transformation process. This history of technological evolution in the financial industry is full of examples of institutions that have focused on technological tools without adequately investing in the organizational capacities that will ensure their impact. This is something we believe is crucial, especially in cultures such as ours.

The "digital journey" comes with great challenges, and without a doubt one of them is having the necessary talent to get through it. Today's business environment requires agility, adaptation, and creation of opportunities. institutions need staff that is committed to their "digital goals", and this has a double impact: On the one hand, the need to obtain and guarantee this commitment, and on the other, the challenge to keep staff motivated and committed. We are talking about workers that want to develop in the digital world regardless of their age, or what generation they belong to. This commitment is accomplished by combining two critical components of strategy execution: **Culture and Leadership**.

All processes of transformation entails risk. It is not impossible (and this is well-known to the banking sector) to have a culture with little aversion to risk. To foster risk-taking, leaders need to change their mindsets; but it would be a mistake to think that this is only an issue for leaders. To encourage staff to be more daring is especially important during processes of transformation. Institutions can (and should) take deliberate actions in that direction because, in the words of Phil Simon, "*today, the cost of inaction is almost always higher than the cost of action*."(9)

We tend to think that innovation comes from the unexpected flashes of inspiration some geniuses have, but actually many new ideas are conceived through the collaborative effort of people from different fields (case in point, the philosophy of ecosystem). Leading institutions are those which are more likely to use mutidisciplinary teams in order to conduct their digital initiatives, and those who are able not to fall into the trap of innovation. That is, those which are able to share the knowledge (a cornerstone of the innovation process) even when the complexity of products and services is all the more evident because of their own innovation. In other words, to avoid the creation of silos so that this complexity can be managed. Once again, this is where we believe lies the key to success.

Here we reach a point where we can wonder if culture can drive the adoption of a particular technology, or if it is the adoption of a particular technology which brings about a change in the culture. Often, institutions think about technology in a very narrow sense, without wondering if a new one could foster new behaviors, and converselyl, if it could inhibit them. This is why, in our opinion, culture should lead to the adoption of a new technology, and this is why it is essential to manage cultural change.

(8) “Strategy, not Technology, Drives Digital Transformation”- MIT Sloan Management Review in collaboration with Deloitte. 2015.

(9) Phil Simon, technology consultant. Author of seven books, among them "Message Not Received".

The digital transformation of business is a relatively new phenomenon, and no outfit has yet reached its final stage; maybe because it is not yet defined, or maybe because innovation may be permanent. What there is no doubt about is that it is essential to move forward if one intends to lead, or just survive. Digital strategies will have face the ever more fuzzy difference between the online and offline worlds.

Digital maturity is the product of the right combination of the three pillars mentioned above: Strategy, Culture, and Leadership. To position an outfit favorably before a true transformation we should consider that:

- The main goal is the transformation of the business. We will get to this point through deep innovation and decision-making.
- Culture and mindsets will have to change in order to increase collaboration and foster risk-taking, in order to achieve greater innovation.
- Leaders do not need to be experts in technology; they should understand what can be done by combining business with technology and thus, how the business can be transformed.
- A successful business is a business that evolves quickly and effectively. Working through ecosystems can speed up evolution because of the synergies that are produced.

Having commented on how matters such as strategy, culture, and leadership decisively influence the process of decision-making, it is now time to attempt to answer the question we posed before. To be or not to be digital. From our perspective, and taking into account everything we have said so far, to be digital is not the question because there is no possibility not to be. **It is an IMPERATIVE!**

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Models of Digital Maturity in Banking

According to the outlook applied we can find different levels of maturity, as follows:

Levels of Maturity \ Type of Model	Survivor	Average	Transformative
Mature			• Leadership and Digital Culture • Transformative Strategy • Work in Ecosystem • Internet of Things • Integrated Digital • Totally Mobile • Strategic Innovation
In Development		• Semi-digital Leadership • Semi-Flexible Culture • General Strategy • Partially Digital • Basic Mobile • Declared Innovation	
Initial	• Leadership by Silos • Scattered Culture • Undefined Strategy • Somewhat Mobile • Basic Digital • Budding Innovation		

Digitally mature institutions are those which are committed to transformational strategies supported by a culture of collaboration and open to taking risks

Conclusion

We have seen how innovation has brought about the so-called "digital revolution", and it is here to stay. We are also seeing how mobility is nowadays our way of life and the possibility of being online almost as much as we'd like shapes our new habits, behaviors, and lifestyles And the world of financial services is no exception. There are countless examples (such as what is happening with means of payment, investment management, and peer-to-peer lending, just to name a few) which lead us to think that change in the business model of financial activities is unavoidable. This is why Being Digital is a must if one intends to be an industry leader, or just survive.

Within the banking sector, one of the aspects undergoing the greatest transformation in this business model is the management of client service channels. This is an issue often referred to as "Omnichannel retailing". This term is useful to reduce the matter only to channel management, but the true issue is wider, and, as we have seen, is related the transformation of the business, and with it, of the service models which will have to necessarily adapt to the needs of the clients ("new" and "old"). This transformation is about achieving synergies between the different types of existing devices. And as we have seen, branches are a key element as part of this transformation.

The emergence of "Fintechs" has shown how innovation creates opportunities at the same time as it gets banking products and services closer to clients in a simpler, cheaper, and accessible way. Banks have leverage their advantages and make use of the innovation capacities of these new players; this is where the ecosystem becomes the ideal work philosophy to be complemented through competitive collaboration. Furthtermore, this ecosystem could be extended by integrating other industries or sectors such as telecommunications. Everything will depend on there being a cultural change.

Institutions from all industries and sectors are using digital innovation to improve efficiency and, especially, the client experience, but the most mature ones stand out because they follow a digital strategy to transform their business. This allows them to be a step ahead of the competition.
Therefore, "Being Digital" is mandatory for future success or survival, but what is the true underlying issue for Latin American financial services institutions? We believe the way in which the issue is tackled is the true issue. A holistic, systemic, and truly integrative approach is key to be successful in this journey. This is a journey that starts with the correct assessment of the right strategy to adopt, continues with the right choice of leadership, especially for Latin American banking. Leadership should have a strong cultural roots which can provide the necessary energy to achieve the goals that have been set.

This holds true regardless of the type of bank in question (public, private, wholesale, retail, microfinance, etc.) because the root of the transformation is the client, their needs and hopes. The cornerstone will be experience, not product. And this is why we should take in to account things like: Convenience, availability (anytime, anywhere), immediacy, access to information, proximity, continuity, and being unique or personal. The business model has changed from "channel centered" to "experience centered".

Successful transformations do not just happen out of the blue. The challenge is to create a new reality that can change what customers (internal and external) perceive and experiment. Only afterward does technology come in.

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