

# PERSPECTIVE

## Latin America: The New El Dorado of Retail Banking



A GDP growth of 5.1 percent in 2007, 300,000 high-net-worth individuals, \$3.7 trillion in investible assets, a predominantly young and underbanked population among the 551 million-strong peoples in the region – clearly, Latin America is ready for an economic take-off.

### Ready, Steady Growth

ECLAC tracks GDP growth rate of 5.6% for Latin America and the Caribbean in 2007 and estimates the region's 2008 growth rate at 4.9%. If these projections are borne out, 2008 will be the sixth consecutive year of growth and, by its end, per capita GDP in the region will have marked up a cumulative increase of 23%, equivalent to 3.5% per year.

– Overview of the Economies of Latin America and the Caribbean, 2007, ECLAC

A region that was beset with political and economic turmoil is slowly but surely transforming itself. With reassuring signs of political stability, Latin American nations are electing democratic governments (the year 2006 saw 13 presidential elections here), opening markets to trade and foreign investment, reducing government budget deficits, embracing more flexible currency regimes, and lowering inflation. There are, though, a couple of exceptions such as Venezuela and Ecuador that appear to be moving in the opposite direction.

The new economic engine is also driving the banking sector which is undergoing significant reform through bank consolidation, privatization, and increased entry of foreign institutions. Most Latin banks have traditionally focused on corporate clients and the moneyed elite. But the competition born of the transformation in banking is leading Latin American banks to increasingly look to retail banking for future income and greater market-share.

A number of factors are making retail banking increasingly attractive and lucrative for the region's banks. These are:

- ▶ **Emerging middle class:** Financial stability and faster growth are starting to transform social conditions with astonishing speed – poverty

levels are falling and a middle class is rising. In Latin America as a whole, according to calculations by Spanish bank Banco Santander, some 15m households ceased to be poor between 2002 and 2006. If the trend continues, by 2010 a small majority in the region will have joined the middle class, with annual incomes above \$12,090 in purchasing-power-parity terms

- ▶ **Underbanked economy:** The unbanked population ranges from 57.20% in Brazil and 58.80% in Colombia to 66% in Ecuador, 75% in Mexico, and 80% in Perú
- ▶ **Bank deposits and assets growing faster than GNP:** Deposits growing at 30% per annum while the economy grows at 5% per annum. Return on assets for the 42 Latin American banks in the Top 1000 is 2.36%, the highest ratio of all the world's regions. Profit on capital comes out at 27.28%, the third highest ratio after that of the US at 28.89% and the Rest of Europe (non- European Union) at 28.02%

### Counting the money

The gross disposable national income (GdNI) of the region's countries has been growing at a higher rate than GDP. In 2007, this aggregate rose by 6.5% while GDP grew by 5.6%

With the rise in the region's GdNI, national saving grew over the previous year, representing 21.2% of GDP at current prices. As has been the case for some years, this was enough to finance regional investment in its entirety

Domestic demand in the region's countries increased by 7.7% in 2007, driven by growth in gross fixed capital formation (11.6%) and by higher private consumption (6.8%), the result of improved labor market indicators and a considerable expansion of bank lending to the private sector

– Overview of the Economies of Latin America and the Caribbean, 2007, ECLAC

## Top banks

The robust performance of the Brazilian economy has led to the country's banks dominating 'The Banker' magazine's list of the region's Top 100 Banks. As many as 26 Brazilian banks account for the following shares: Tier 1 capital - 53.8%, assets - 54.5%, and pre-tax profits - 52.3%.

Eight banks from Mexico make it to the list, contributing 22%, 15.2% and 25.9% of the same aggregates. Chile has 13 banks in the list, Argentina 11 and Panama 10. The total for the Top 100 for Tier 1 capital was \$119.1 billion, while assets grew 29.0% to \$1419.6 billion. Pre-tax profits increased 9.9% from a year ago to \$33.2 billion.

The top 10 comprises of seven Brazilian and three Mexican banks. Banco Itaú Holdings is the number 1 bank in the latest rankings, pushing down Banco Bradesco to the second slot, while Banco do Brasil is in third place. In fourth place is Banamex, just ahead of BBVA Bancomer.

This paper explores characteristics of retail banking in Latin America that will help us understand the way forward for institutions to capitalize on the opportunities in the region.

### Retail Banking in Latin America: An Overview

Latin America is a vast and diverse region of some 20 countries. Part of the emerging BRIC powerhouse, Brazil leads the region with the largest economy. Its GDP surpasses a trillion dollars (by purchasing power parity, \$1.8 trillion), making it the eighth largest economy in the world. Other large economies of the region are Argentina, Colombia, Chile, Mexico, Peru, and Venezuela.

### Banking on a Roll

It has been a bumper year for private banks in Latin America. According to a 2008 private banking poll, net incomes for private banks increased in Brazil by 29.3%, in Mexico by 19.5%, in Argentina 18% and in Chile 11%. The four countries remain the largest markets for wealth managers in the region, and the battle between the domestic and global private banks is increasing. The good news is that Latin America's wealth is growing at a rate that should allow room for all banks over the next few years. High-net-worth wealth in Latin America is expected to grow at an annual rate of 7.2% from 2006 to 2011, outpacing the global growth rate of 6.6%.

## Trends and Opportunities

### Internationalization and Consolidation

The Latin American banking market is changing rapidly. From the mid-1990s, American and Spanish banks have led a foreign invasion, radically changing the banking landscape. Through a series of dramatic moves and mergers and acquisitions by global players such as Banco Santander, BBVA and HSBC, the share of foreign ownership in the banking systems of Latin American countries has soared. Most of these acquisitions have been made by non-US institutions. Thirty-one of the Top 100 banks are foreign-owned, 29 by single banking entities, and two either by banking consortia or non-banking companies.

Recently, Citigroup announced that it had acquired Grupo Financiero Uno (GFU), the largest credit card issuer in the region, and its affiliates. The acquisition of GFU, with \$2.1 billion in assets, will expand the presence of Citigroup's Latin America consumer franchise, enhancing its credit card business in the region, and establish a strong platform for regional growth in consumer finance and retail banking. In November 2006, HSBC completed the \$1.77-billion acquisition of Panama's Grupo Banistmo S.A. (Banistmo), the leading banking group in Central America.

The preponderance of foreign banks is a result of the economic policies followed after the financial crises. Foreign players have played an important role in shaping and developing the Latin American banking industry. Not only have they injected capital into the banking system, but they have also introduced new products, technologies and management expertise.

It is important to bear in mind that unlike the rest of the region, Colombia holds an impressive and larger participation of local private banks led by Bancolombia, Grupo Aval and Banco Davivienda.

### Growing Market-share

Consequently, competition is heating up. In an effort to grow their market-share, foreign banks are willing to lend on longer terms and aggressively market real estate loans, auto loans and corporate bonds. Local consumers and businesses are finding it easier to get longer terms for loans at lower interest rates even as government regulations are slowly easing up. Non-traditional players have also entered the market. Mexican regulators are awarding banking licenses to retailers in hopes of serving the "unbanked" sector, such as small and medium-sized firms.

Though some local players are being gobbled up by foreign players as the market consolidates, in Brazil, local bank Banco Itaú has captured the market by concentrating on customer satisfaction instead of branch development.

Banks are also exploring the possibility of including the large lower- to middle-income sectors in search of revenue and market-share. Narrowing interest margins as a result of low average interest rates and competition from foreign banks and non-bank entities are just some of the key factors driving the new interest in the hitherto underserved segments.

Banks are devising innovative ways to make basic personal banking accessible to the lower-income sector – checking accounts, savings accounts, residential mortgages, personal loans, auto loans, credit cards, and services such as electronic banking, custodial arrangements, and foreign exchange transactions. Traditionally, these banking products have been geared towards the middle and upper income clients in the region, and the challenge has been to modify them to suit lower-income individuals.<sup>10</sup> New technologies and access to credit scoring models are making it easier for banks in Latin America to create such

innovative products at lower costs and risks.

While the high-income segment has traditionally been the target of banks in this region, the growing middle class and the unbanked lower-income segment clearly constitute a lucrative opportunity going forward.

Enjoying economic growth and relative financial stability, Latin Americans are eagerly lapping up retail banking products like loans and credit cards. Brazilians are scooping up consumer goods on credit and taking on mortgages to buy homes. Total bank loans in the country have more than doubled over the past four years, passing \$530 billion, and banks have raked in record revenue. The banking system's assets grew by 19 percent in 2006 alone to cross \$1.1 trillion.

### Unbanked Population

Chile reports the highest retail banking penetration and the lowest percentage of its population living below the poverty level. It is followed by Brazil, where the majority of households have checking accounts because most payrolls in the formal economy are administered electronically. Nonetheless, access to consumer credit in Brazil is mostly limited to the middle and upper class, and even foreign banks primarily target customers with an annual income of at least \$20,000.

In Mexico, the formal banking sector has targeted only the top 15 percent of the population, while the other 85 percent is considered too risky and unprofitable. Now, however, more foreign banks have begun to pay closer attention to the retail credit card business and other remittance-linked products. In Colombia, where 55 percent of the population lives under poverty level, access to bank credit is low at 23%.

Banks are recognizing the potential of Latin America's enormous unbanked population. To exploit this opportunity and grow market share, Latin American banks are concentrating on new retail products. To serve the banking needs of relatively low-income economies with low penetration requires innovative and imaginative non-branch solutions.

Bancomer is reaching out to the lower-income segment by offering simplified and more accessible products, such as pre-paid credit cards or cards with fixed monthly payments. To cultivate a culture of savings in Mexico, Bancomer has made available

a savings account-debit card combo for a minimum deposit of about \$70. Bancomer, like many large banks in Latin America, is also developing a keener focus on the growing mortgage business.

Santander Banespa, a Spanish-backed bank in Brazil, manages about 5.1 million customers and 1800 branches. It has grown steadily in recent years by concentrating on personal lending, car financing, insurance, and investment funds. It helps that local interest rates are dropping and that Brazil's government has introduced incentives to increase credit. For example, payroll loans, whereby installments are debited from paychecks are now permitted.

## Conclusion

Although retail banking has been relatively slow to take off in Latin America, it is catching on as a result of competition and innovation. Its accelerating acceptance and growth have enormous implications for the region. However, keeping in view the economic status of the region's inhabitants, banks need to put in place solutions that target and include all sections of society. To succeed in their objectives, retail banking products will need to apply existing best practices in low-cost banking and use remittances through specially tailored financial products, electronic banking, technology, alternative distribution methods, and alternative risk management.

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