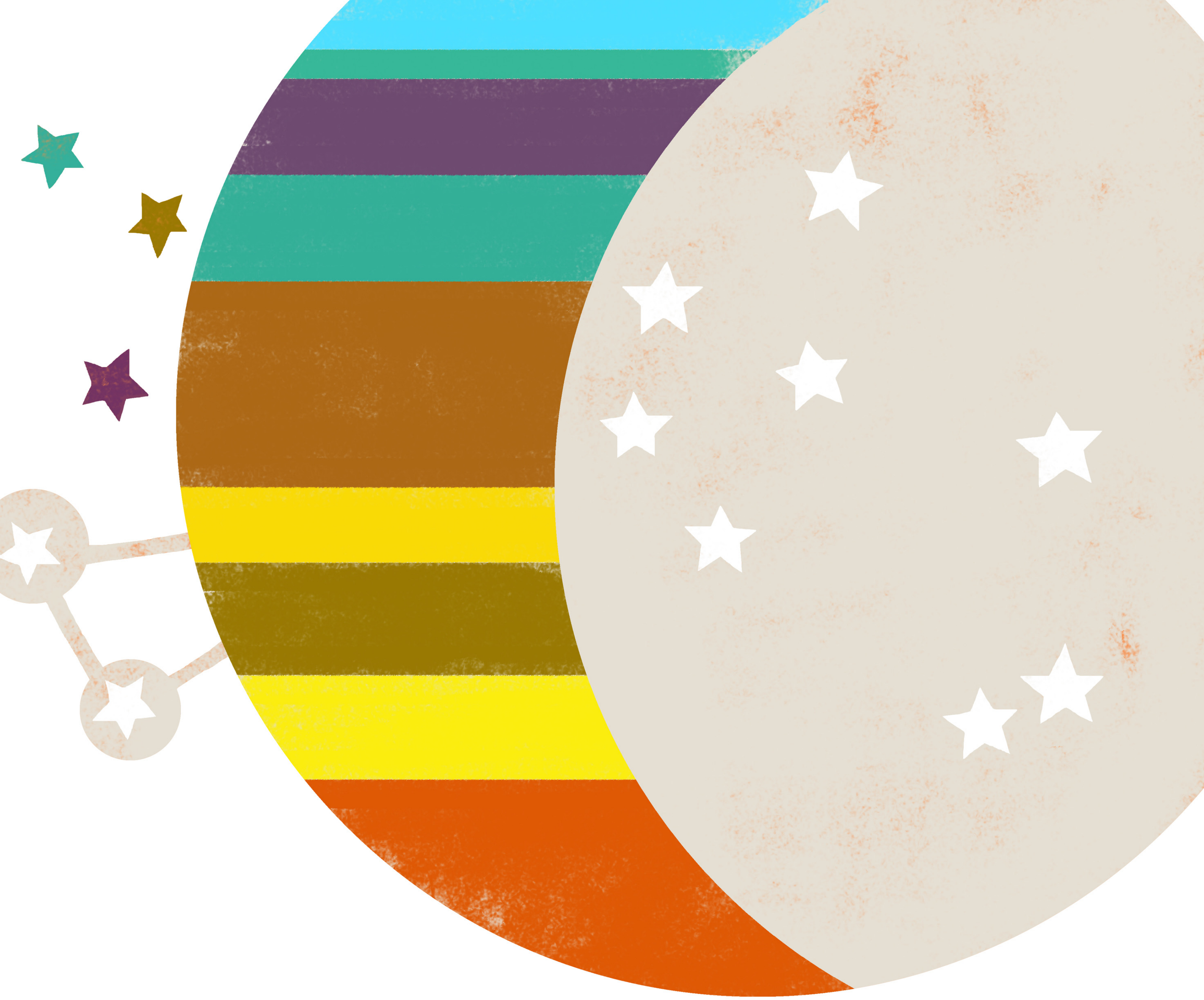


Transforming a high-performing company:

An interview with Roberto Setubal

The CEO of the former Banco Itaú—and now of Itaú Unibanco—describes the problems of changing a company that is set in its successful habits.

Frederico Oliveira

It’s unusual for a CEO who has led a company through more than ten years of strong growth and financial performance to stop and consider whether the business should be run differently to meet future challenges. It’s even more unusual for such a chief executive to initiate a major transformation introducing a new way of managing this highly successful company—a transformation involving its culture, organizational structure, decision-making processes, and leadership style.

Yet this is precisely what Roberto Setubal, the CEO of Brazil's Itaú Unibanco, launched in 2005. By then, decades of steady organic growth and well-chosen acquisitions had made the company, founded in 1945 and controlled by the Villela and Setubal families, Brazil's second-largest private-sector bank and one of Latin America's most profitable institutions.

In November 2008, midway into the change effort, Banco Itaú and a domestic competitor, Unibanco Holdings, agreed to a merger forming one of the world's top 20 banks by market capitalization. Setubal, named CEO of Itaú Unibanco Holdings, here speaks to McKinsey director Frederico Oliveira about Itaú Unibanco's journey from a command-and-control management model to an open and creative dialogue, and what the merger will mean for this journey.

McKinsey: *What role will the merger play in the company's emerging new management culture?*

Roberto Setubal: I believe the merger with Unibanco will accelerate the change because in many ways Unibanco was ahead of Itaú in the process of creating an open environment for discussion and reducing the role of hierarchy. If one had looked at both banks ten years ago, the cultural differences would have been more visible, but during these years both banks have been moving internally in the same direction, albeit from different starting points. During the merger negotiations, culture was probably the most discussed issue because we both wanted to make sure that the fit was good enough to create a company with outstanding performance.

McKinsey: *The economic crisis is high on everybody's minds at the moment. How will it affect Itaú Unibanco?*

Roberto Setubal: The Brazilian banks were not at all directly involved in the subprime crisis, so we will suffer only the consequences of the slowdown of Brazil's economy, a slowdown that will be much smaller than that in the OECD[1] countries. I believe 2009 will be a difficult year, but as Brazil's economy adapts to the new global economic situation, our internal demand, which is quite high, will be an important instrument for reactivating the economy. I believe it can recover to a 3 or 4 percent growth level in 2010 or 2011, even if we don't see a recovery in the OECD economies.

[1] Organisation for Economic Co-operation and Development.

McKinsey: *Let's go back to the beginnings of Banco Itaú's transformation program. The bank was performing very well. Why did it need to change?*

Roberto Setubal: The bank had been growing by up to 25 percent a year for more than ten years, and its performance was still very good in 2005. Yet I began to realize that it had become such a large and complex organization that we could not continue managing it in the same centralized way as before. Competitors were closing the gap somewhat, and while we've always been very good at implementation, innovation and the flow of ideas within the company were not quite as good as I thought they needed to be if we were to maintain our competitive edge. The conclusion was that we needed a higher-quality decision process in order to prepare ourselves for a demanding future.

McKinsey: *What was wrong with the decision process?*

Roberto Setubal: I had always been a very hands-on CEO and the bank was much too centralized in my own person. Because the management model hadn't changed as the company grew bigger and bigger, I ended up having more than 20 direct reports, creating an impossible situation. At the same meeting, we could discuss big issues, like a large investment for expanding our operations, and small ones, such as very basic product problems. What we really needed was to delegate decisions and create forums for different types of issues—forums with the right people present and with enough time for everybody to bring their

Roberto Setubal

Vital statistics
Born October 13, 1954, in São Paulo, Brazil

Education
Graduated with degree in production engineering in 1977 from Escola Politécnica of the University of São Paulo, Brazil

Earned MS in engineering in 1979 from Stanford University

Career highlights
Itaú Unibanco (1985–present)

CEO, Itaú Unibanco (2009–present)

President and CEO, Banco Itaú (1994–present)

President, Banco Itaú Holding Financeira (2002–present)

Vice president of management council, Banco Itaú Holding Financeira (2002–present)

Chairman of board of directors, Banco Itaú–BBA (2003–present)

Member of board of directors, Banco Itaú (1995–2003)

Citibank (1983–84)
Joined staff of then-CEO John Reed, later served as vice chairman of individual banking

Fast facts
Member of Council of International Monetary Conference and of international advisory committees of Federal Reserve Bank of New York and New York Stock Exchange (NYSE)

Serves as vice president of the Institute of International Finance (IIF)

Served as president of National Federation of Banks (Fenaban) and Brazilian Federation of Banks Association (Febraban)

own ideas to the table and engage in open and creative discussion. If you went to school in the 1960s, you learned a lot of things that were very modern for that time. But if you go to the same school today, they teach you other things. The world is moving and the company has to move with it.

McKinsey: *What are the main elements of the transformation program?*

Roberto Setubal: We are creating a new management model, which involves the organization's structure as well as processes. But to get this done, we need to change the way people think and act. So the first part of the transformation was to work on culture, particularly how our people voice their ideas and concerns. I believe it is very important to have all the information and ideas on the table before we make a decision, and I was looking for a more open environment for discussion. We started with top management and quickly worked our way down to create bottom-up "pull" for change. As this took off, I made it very clear that the change was for the sake of performance, not for fun—that it was for keeping our competitive edge.

So as a new culture began to take root, we started to implement the foundations—the hard stuff—

Here we were, proposing an environment where executives could no longer hide in their big offices but had to engage in open debate with their teams

in terms of processes linked to the new culture. This involved a redesign of the decision-making and risk-management processes in order to foster innovation, speed, and accountability. It also included a revision of performance-management systems—a revision involving very concrete individual and group targets, compensation programs, and in-depth leadership reviews. In a word, the way the bank actually works has been redesigned to support the new culture that is under development.

McKinsey: *How did this start—what was the very first step?*

Roberto Setubal: The initiative was mine, and the first step was to get the board on board. First, we had to agree where we were and where we wanted to go. This took a few months, and some people were very skeptical to begin with. Then we started to involve other levels of the organization, and we had the big announcements and ceremonies that play an important role.

McKinsey: *What role have you played as CEO?*

Roberto Setubal: The role of CEO is key. If you want change to happen, you have to change your own ways. I realized that the decision-making process was a reflection of how I used to manage the company. So if you want the company to be more democratic, you have to allow yourself to be challenged by others. You have to commit yourself totally and really believe that this is the right way to go. This is very difficult in the beginning because sometimes I knew that I could make the decision much faster on my own. But once we created an environment of discussing and listening to what others were saying and implemented a good process for making decisions, I could delegate more and rely on five or ten smart people with different backgrounds to make better decisions than one person.

McKinsey: *Changing an organization that is doing well is usually very difficult. What has your experience been?*

Roberto Setubal: There was some resistance. Some old-style people were saying, “We are doing well; why should we change when we don’t need to change?” It was very interesting that while the top team agreed that we needed to improve the way we made decisions, the moment of truth was when we really started to bring the changes into the day-to-day environment. It’s a very complex endeavor to change a winning company. In such a company, everybody is very proud, and they feel that the way they have done things for years is the right way. Some people were not able to go through this process of change, although in some cases they tried very hard, and eventually left the company. Others were mentally prepared and they wanted these changes to happen.

It was hard for many midlevel executives who were used to being powerful and not having their decisions questioned. Here we were, proposing an environment where people should offer their frank opinions and where executives could no longer hide in their big offices but had to engage in open debate with their teams. There are still many people in the company who are struggling to adapt to these changes.

McKinsey: *When did people really understand that the change was for real?*

Roberto Setubal: When very important people who reported to me and who could not adapt started to leave the company, others began to believe that change would actually take place. In the past, we used to accommodate high executives whose performance was not fully satisfactory. Never before had anybody at the top level left the company. Those who had reached that level went on and on until they retired. Now colleagues with 10 or 20 years tenure left because they decided that they couldn't adapt to the new culture. This was very hard for them and the people around them, but as we move forward on the path of change this becomes more of a natural process. People understand that you simply have to perform, and you not only have to deliver results but you have to deliver them in the right way.

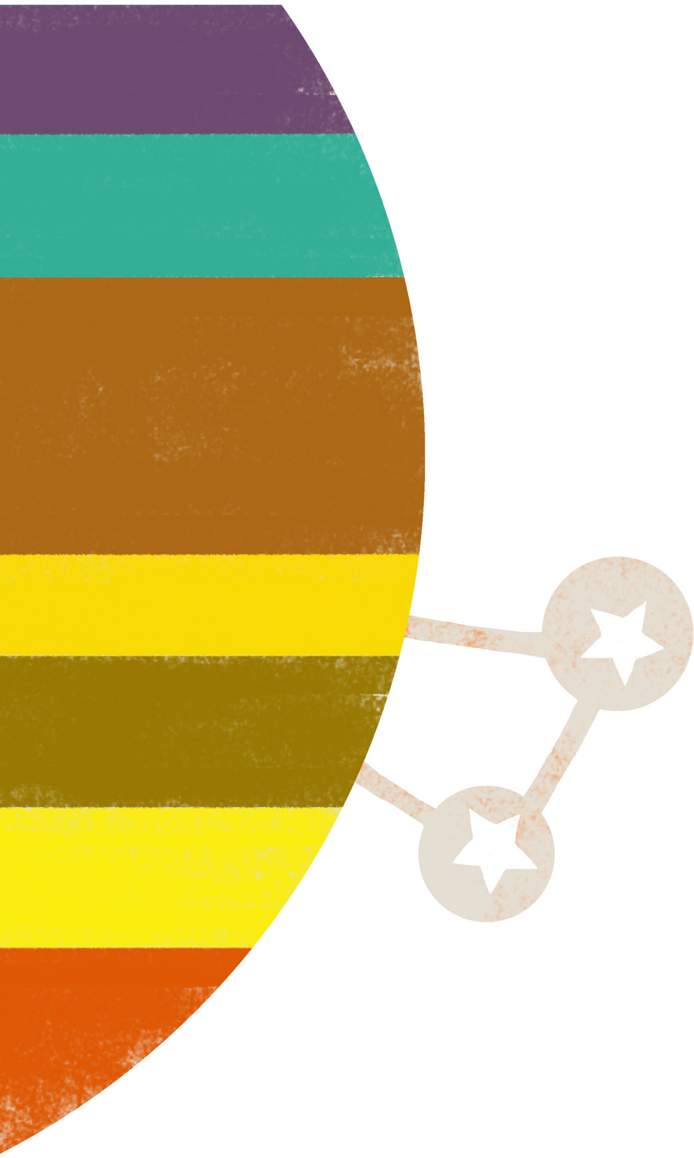
McKinsey: *There are also people requirements for a successful transformation. How are you handling demand for the kind of talent that would help make the new management model a success?*

Roberto Setubal: By hiring them. Indeed, one of the objectives of changing the company culture was to be able to attract the best talent. Itaú used to be a closed career. It was only 10 to 15 years ago that we started recruiting people from the outside to the higher ranks of the company. We always had good talent internally, and this is probably more true today than ever before, but when the bank is growing by up to 25 percent a year there are a lot of new positions to fill in order to continue growing at that rate. Today, unlike in the past, I think potential hires perceive Itaú as a rather attractive place to work—as a winner in the marketplace, with good remuneration and career prospects. That's what they see when looking in from the outside.

You have to meet these expectations so that when people are here they want to stay. This has not always been the case. Sometimes we brought in good people who left the company after a while because they felt they did not get a chance to contribute in the way they could. The new generation coming into the labor market has different expectations than the generation of 20 years ago. Talented people don't come here just to perform tasks. They want to offer their ideas, discuss freely, grow professionally, and contribute to the future of the company. We have to create this kind of environment or we'll end up with the yes-man type, which is not what we're looking for.

McKinsey: *What kind of changes in the organization's design and processes did you use to take the step from cultural change to operational improvement?*

Roberto Setubal: We have been redesigning our decision processes in many ways to align them with the cultural changes. I mentioned that I used to have 20 direct reports. Today I have 10. To make this possible, we reorganized our formal systems. We have moved away from functional areas to real profit centers. For example, we used to have a vice president responsible for credit. All business lines depended on this



person for approving important credit decisions. These decisions are now made by business unit executives. This is in line with one of the goals of the change program—to make decisions at the appropriate levels and in appropriate forums, which also frees up time for the top team to discuss strategic issues. At the same time, we created safeguards for the new credit decision process so that the corporate center retained strong control over it while allowing the profit center to have a lot of flexibility.

This is a completely different way of doing things because now the business unit leader has the autonomy to design strategy in terms of pricing and risk as long as it is in line with the preestablished policies. The business unit leader can make decisions together with the team in a better way than before, when there was a very centralized process and the person in charge was overseeing too many businesses to be fully involved.

McKinsey: *What did you change in the way the company evaluates, compensates, and promotes its people?*

Roberto Setubal: We always tried to be very professional about people management, but we had a closed and centralized system. We've now made it more transparent, with checks and balances built into the process so that they would not only be in place but would also be perceived as being in place. That is important because without transparency people start questioning how serious the process really is. Today, a leader who evaluates a person must justify why he or she is proposing to promote one individual and not another. You can no longer sit alone in your office for an hour and decide who should get a higher bonus. You have to discuss with others and listen to their opinions. This new process is at the heart of modernizing the company's culture.

McKinsey: *How have you balanced the pace of change with the need to preserve the strengths of the organization?*

Roberto Setubal: We wanted to change, but at the same time we wanted to maintain our professional and performance-oriented culture. In the days of command and control, we operated like an army. Once a decision was made—whether it was right or wrong—it would be implemented immediately, and a few months later you would see the result. We did not want to lose this efficiency.

That's why we've changed step-by-step and been flexible about the timing of the changes. I think that in order to find the right balance, you have to be firm about the direction, but you don't have to go fast. We give people time to adapt and gradually build confidence about the process. As a result, I think we now have a better decision process than we did before, without having lost our ability to implement quickly and efficiently.

McKinsey: *Was it easier or harder to make change happen in a family-controlled business?*

Roberto Setubal: I don't think the ownership structure is a crucial element. What is critical is that the CEO should really get involved, lead by example, and basically walk the talk. In our case, being a family-controlled company made it easier in many ways, as I was the CEO and also part of the family, which made my mandate stronger. But I believe that the CEO is always the CEO, and what counts is that this individual should have the support of the board, which of course represents the owners, family or not.

McKinsey: *How far along is Itaú Unibanco today in its transformation efforts?*

Roberto Setubal: We started three years ago, and I would say that we've come halfway on a long journey. Our people realize today that change is not just a concept—it's not a question of, "OK, let's be nice and democratic and listen to what everybody has to say." They understand that the new, open culture is about arriving at the best decisions.

McKinsey: *What's your advice to other CEOs contemplating a business transformation?*

Roberto Setubal: You have to be patient, persistent, and brave at the same time. Your actions as CEO will be absolutely crucial, so first of all you have to be very committed to what you are going to do. If you really are, people will follow you. If you think you don't have to walk the talk, it won't work at all. The second condition is that you have to be prepared to make some tough people decisions, sometimes about colleagues who are very close to you. This was not an easy thing for me to do. But everybody has to understand that the company comes first; we are here to do what is best for the company.

Frederico Oliveira is a director in McKinsey's São Paulo office.