BLOG

Technology, talent and risk management – Striking a balance amid a recession

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A recession makes companies manage their businesses with limited resources as they anticipate more adverse conditions ahead. Balancing focus on the key areas of technology, talent and risk management is, therefore, seen as key to weathering these troubled times, especially for the banking sector.

Maximising efficiency through technology with limited investment

Now more than ever, companies need to maximise the efficiency of their spending on technology while expecting a contraction in their investment. The global lockdowns have emphasised how essential it is to have robust digital infrastructure. Technological developments have been used widely in sales and marketing, procurement, distribution and logistics so far, but in the current context, more innovative solutions are being formulated or redesigned to keep abreast of trends and demand. The lockdowns have also necessitated the use of online banking, even for those clients who were sceptical of its use before. The banking needs of individuals and corporates have evolved – moving beyond simply checking account balances or transferring between accounts. Emerging needs such as remote authorisation of transactions, remote cheque printing, trade transactions and remittances with minimal or no original documentation, automated payroll systems and cash management systems are in particular demand now. The use of data, advanced analytics, artificial intelligence and other relevant technologies is of utmost importance, and many banks were already aligned for such developments in order to compete with emerging fintechs. Apart from catering to external customers, internal processes and workflows could also be streamlined to accommodate changes in work routines. Banks may need to ensure work-from-home (WFH) capabilities or operate from disaster recovery (DR) sites to operate smoothly. The use of cloud-based computing and project or task management software should, therefore, be considered in addition to the critical regular maintenance and upgrade of core banking systems.

Furthermore, external software and applications for communications have increased the popularity of Microsoft online meeting and conferencing (which witnessed a 500% increase in usage) and Zoom (a cloud-based video communication tool that saw its daily participant base grow from 10m in December 2019 to 200m as of March 2020).

Banks need to prioritise capital spending on technology considering the long-term profitability and economies of scale expected. Certain innovations could be less costly if ideas are implemented through effective utilisation of existing resources.

Retaining core talent while postponing development and uncritical expenses

The strain on companies' revenue, which trickles down to negative profitability, triggers large-scale cost-reduction initiatives. Most banks have resorted to cutting staff costs through reducing training and development costs, halting allowances and incentives and, in some cases, reducing basic salaries or even dismissing staff. Banks need to focus on retaining core talent critical for business success, especially highly specialised staff competent in risk management, IT and finance who will play a key role in the company's facing and surviving a recession. The emergence of new concepts such as WFH that some countries have mandated given the extent of the spread of the infection is enabling employees to explore alternative work methods that banks had not utilised due to regulatory and compliance issues. Banks are challenged in terms of ensuring strict control during this period, without compromising on safety and confidentiality, and much of this responsibility lies with staff at the operational level. It is, therefore, imperative that banks educate all staff on current banking processes and controls in place through regular communication, e-learning and circulating procedure manuals as necessary. Additional expenses would be incurred for setting up new working conditions, but these are likely to be offset by saving on office overheads, leaving room to accommodate the necessary core staff costs.

Financial risk management is key to surviving an economic downturn

Financial risks are at the forefront of the many risks banks face amid the current economic environment. The four main types of financial risk are as follows:

- Credit risk – The possible loss due to failing to honour a contractual obligation such as debt repayment
- Liquidity risk – The potential loss due to failing to realise an asset or raise funds to meet a commitment; also known as funding risk
- Market risk – This includes interest rate risk and currency risk that could cause potential losses due to market rate movement
- Operational risk – Risk arising from operational failures; this can be further classified into fraud risk and model risk

Prior to assessing the probability and extent of each risk type, we need to understand the current global scenario. The lockdowns and restrictions on movement have halted the operations of most businesses. The global economy is expected to contract by 3% in 2020, according to IMF estimates in mid-April; this would be far more severe than the contraction of less than 1% during the 2008-09 recession. The IMF expects the US economy to contract by 6% in 2020.

The drop in global production exposes companies to unforeseen financial risks, despite the prudent risk management strategies that banks may already have in place. Banks are particularly exposed to credit risk to their loan portfolios. The limited repayment capacity of borrowers due to the decline in sales turnover and cash flow is likely to increase default rates, leading to higher non-performing loans (NPLs). The US Federal Reserve and global central banks have already taken the necessary measures to curb NPL ratios through stimulus packages and relaxing capital requirements. The criticality of a stable banking sector was learnt from the Great Recession of 2008, when many strict policies such as the Dodd-Frank Act was implemented to minimise the risk of banks collapsing. Apart from such measures and controls, banks and institutions with credit exposure need to strategically re-align repayment structures considering the COVID-19 impact, in some cases, offering moratoriums.

Market conditions disrupting demand for asset sales are likely to increase liquidity risk, deterring banks from converting assets to cash, greatly needed at times such as these when incomes are constrained. An asset sale, however, should be the last resort, and mitigating liquidity risk through a closer evaluation of market trends could help banks maximise realisable value. High-frequency trading, which uses market asymmetries of information, could also be used to increase liquidity while minimising transaction costs.

Market risks due to increased volatilities are causing a dire financial impact. The Federal rate cut to 0.25% has put an immediate strain on profitability due to its impact on the cost of funds of existing loan portfolios, although this should be rectified in the longer term. The rate benefit will likely be passed on to customers, especially individuals and small businesses that have been the most affected by the lockdowns.

We believe the areas mentioned above are of strategic importance in the present context and that decisions made to effectively allocate and maximise a bank's resources for each area could determine its sustainability.

Acuity Knowledge Partners boasts a large number of experts in both finance and technology. They are capable of delivering customised solutions that incorporate a balanced view of the abovementioned areas through our research and analytics verticals to help clients manage their resources.

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