6 fundamentals banks can use to turn Covid challenges into opportunity

In the year ahead, banks are likely to be impacted by greater company defaults and business insolvencies as the toll of the pandemic is fully reflected in corporate financial statements.

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“However, the report also notes that there are opportunities for banks to cement their role as a trusted business partner by reinforcing their risk management and compliance capabilities through quantitative risk analytics that can help them advise their clients on measures they can take to weather the storm, better manage risk and strengthen their balance sheets,” says Tijsbert Creemers, managing director and partner at Boston Consulting Group, which compiled the report.

Mitigation matters

This follows a year in which South African banks put mitigation measures in place to minimise the impact of the pandemic such as strengthening risk provisions and buffers to ensure greater resilience, as well as enabling much-needed support for their customers through digital value streams that ensured capacity to provide more services.

“While South African banks experience pressure, they are still profitable and in a solid position because they have taken buffers and provisioning into account,” says Creemers.

But this cushion, and the strong position of South African banks, could be eroded as the pandemic enters its second year. If the global economic outlook worsens, the impact is likely to be felt differently from country to country. Banks in nations where tourism, real estate, or transport make up a larger share of the industrial mix will be most affected.

Safeguards

According to the report, banks must apply six core levers to help them emerge from the crisis in a position of strength:

1. Upgrade scenario planning using refreshed data that allows banks to effectively evaluate operational, business, and financial vulnerabilities at the portfolio level.
2. Shift to active credit portfolio management by establishing a dedicated credit-portfolio management unit tasked with deriving optimisation recommendations.

3. Augment collections and workout capabilities while creating supporting digital infrastructure.
4. Optimise the balance sheet and P&L, working methodically to examine each core area and optimising layer by layer.
5. Advance compliance and nonfinancial risk management by formalising and standardising governance frameworks.
6. Accelerate digitisation with an emphasis on cloud adoption to gain agility and resilience.

“To pick up the pace, South African banks will need to continue to invest in building digital capabilities, particularly in artificial intelligence (AI), data and quantitative risk analytics, to better predict and mitigate risks, and optimise efficiencies and costs,” says Creemers.

Quantitative analytics

Banks can use quantitative risk analytics to take data about buffers, cash cycles, and value chains, among others, and evaluate whether they are taking the necessary precautions to mitigate risk and weather a crisis. They can also use this data to look at and implement measures and levers that will safeguard against crises through stronger risk management and an optimised balance sheet and P&L – while also improving scenario planning by considering market nuances.

“The important next steps for banks are to understand for which clients they are willing to extend exposure and for which clients they should be more cautious. Quantitative analytics is a must-win battle for banks to do this better than their competition,” says Creemers.

“The pandemic served as a necessity, but also an opportunity, for South African banks to unlock and leverage the value of analytics and data to understand their business, and fortify against risk and crises. Banks have an opportunity to build on these capabilities over the months ahead, and leverage them effectively for success.”