Doing well while doing good

How the capital markets industry could help master the global pandemic

accenture

In the period since COVID-19 became a global issue, it has posed two primary challenges to the capital markets industry and a call for transformation along with broader economic fall-out.

While the vaccines are ready, it will still take significant time for industries to stabilize, and the challenges are far from over. The pandemic has accelerated the need for technological transformation, putting pressure on firms to speed up the process of innovation. Projects involving the digitization of value chains or the need to bend the cost curve are being pushed much faster than they might have been planned pre-COVID-19. At the same time, the virus' spread has set the stage for a looming global credit crisis (see page 3), as the ability for people to gather in ways that facilitate commercial behavior has been upended, damaging economies.

Given their central role in many economies as capital stewards and capital deployers, capital markets firms face the unique challenges of providing capital while managing their own balance sheets, returns and exposure.

It's fair to conclude that the capital markets industry sits in the eye of a powerful storm. While financial markets are again near their peak valuations and the private equity industry sits on record dry powder, many of the industries they invest in are now facing unprecedented challenges and potential waves of bankruptcies.[1] The looming credit crisis presents capital markets firms with an opportunity to grow revenues by adapting their operating models to meet the needs of the moment, and in so doing, also address an important societal need. At the same time capital markets firms have to avoid the mistakes of the last economic crisis and actually work to solve the underlying structural cost and operating model issues facing the industry.

Overview of gross domestic product (GDP) impacts by sector and country

The impact of COVID-19 on sectors varies significantly, from automotive and retail in the worst affected sectors to communications and high tech in the least impacted sectors. Further variations exist across markets.

2020 GDP Growth (as of Oct 2020)	-4.6%	-11.0%	-9.7%	-6.1%	-9.9%	-11.1%	-3.9%	-4.3%	-5.9%	-9.0%	-7.7%	-9.0%	2.1%	-1.6%	-8.5%	-4.5%
	USA	UK	FRA	GER	ITALY	SPAIN	IRL	AUS	JPN	BRA	COL	INDIA	CHINA	IND	SAF	Global
Comms & Media	6%	9%	7%	6%	5%	7%	10%	8%	6%	5%	5%	9%	7%	9%	5%	7%
High Tech	13%	8%	7%	6%	7%	7%	11%	9%	9%	4%	6%	9%	12%	9%	8%	11%
SW&P	12%	7%	7%	5%	6%	7%	10%	8%	7%	5%	2%	9%	11%	9%	2%	9%
Banking	-12%	-16%	-19%	-11%	-13%	-16%	-9%	-10%	-10%	-11%	-6%	-11%	4%	-5%	-13%	-9%
Capital Markets	-8%	-9%	-16%	-12%	-13%	-13%	-9%	-7%	-8%	-11%	-7%	-11%	5%	-3%	-12%	-6%
Health	7%	5%	2%	3%	3%	4%	3%	5%	6%	4%	3%	5%	4%	5%	3%	6%
Consumer Goods	-5%	-16%	-17%	-9%	-14%	-15%	-13%	-8%	-7%	-17%	-12%	-16%	3%	-5%	-13%	-6%
Construction	-7%	-12%	-14%	-8%	-12%	-15%	-11%	-6%	-9%	-7%	-7%	-17%	4%	-4%	-12%	-6%
Industrial Equipment	-10%	-12%	-12%	-8%	-10%	-11%	-10%	-6%	-9%	-10%	-9%	-16%	2%	-6%	-8%	-7%
Automotive	-22%	-24%	-18%	-16%	-19%	-21%	-18%	-11%	-10%	-20%	-25%	-13%	-5%	-7%	-17%	-15%
Public Transport	-16%	-29%	-27%	-21%	-24%	-26%	-23%	-13%	-13%	-15%	-17%	-15%	-8%	-3%	-11%	-15%
Retail	-6%	-22%	-15%	-9%	-13%	-19%	-17%	-10%	-13%	-16%	-11%	-15%	-3%	-9%	-14%	-10%
Travel	-18%	-24%	-18%	-21%	-20%	-23%	-22%	-19%	-16%	-16%	-15%	-18%	2%	-6%	-16%	-17%
Chemicals	-5%	-13%	-12%	-7%	-15%	-14%	-13%	-10%	-8%	-15%	-17%	-9%	-2%	-5%	-11%	-7%
Energy	-8%	-9%	-7%	-11%	-9%	-9%	-8%	-7%	-6%	-9%	-11%	-6%	5%	-3%	-7%	-5%
Utilities	-6%	-12%	-11%	-9%	-10%	-11%	-9%	-6%	-7%	-8%	-11%	-7%	5%	-3%	-8%	-5%
Real Estate	-9%	-19%	-19%	-10%	-18%	-19%	-16%	-12%	-9%	-13%	-10%	-15%	3%	-10%	-8%	-11%

Key Points

- The variation in sector impacts across countries is closely linked to the length of quarantines (e.g. retail is impacted worse if quarantines persist)
- Certain "essential" retail sectors are still doing well as they are less linked to discretionary demand of spending
- There are nuances around energy which are not related to the virus outbreak—but more to global energy and production cuts associated with OPEC+

□ >0%   0 – -10%   -10 – -20%   < -20%

Sources: World Bank, IMF, IHS Markit, Oxford Economics, Accenture analysis

Credit crisis

PHASE 01 — **Iterative Global Government Stimulus Packages**

Strong fiscal and monetary responses in developed economies, although transmitted slowly at times.

New responses are more targeted, moving from immediate relief to building resiliency.

PHASE 02 — **Financial Institutions Providing Liquidity via other Credit Solutions**

As public mechanisms for financial help get exhausted, financial services must step in, creating the potential for both credit and reputational risk.

PHASE 03 — **Moving to Equity & Industry Ownership Implications**

There's an inherent trade-off between investing to future-proof business models and near-term pay-outs.

Providing liquidity through equity can pose challenges for the fragmented small and medium enterprises (SME) sector.

The current scope of the response from policy makers, combined with the performance of companies of all sizes in the context of the constraints imposed in response to COVID-19, give us enough data from which to forecast how a burgeoning credit crisis could play out. We anticipate it might move through three phases.

Phase 1 has been characterized by both broad and targeted government support for the economy, which has helped stave off some of the worst effects of the current recession. Banks have carried out many of these policies, though without committing their own capital. Capital markets firms haven't played much of a role in this process and have been largely insulated from many of the negative effects of the current recession.

Phase 2 begins as public support programs run their course and businesses seeking capital have to turn to private sources, which could assume the risk in these transactions. Banks will bear the initial burden of lending, particularly to small- and medium-sized businesses, which are typically too small to seek funding through the capital markets. However, as banks tighten their lending standards and their balance sheets reach capacity, capital markets participants may face pressure to develop new solutions to meet funding needs for companies that still have viable go-forward business models while minimizing potential investor losses. Signs of this are emerging in the EU, where the European commission is looking to develop secondary markets for distressed assets to allow banks to move non-performing loans off their balance sheets.[2]

Phase 3 is expected to begin once banks and investors have exhausted their ability and willingness to lend, even as companies still need liquidity to operate. At that point, companies may become increasingly open to solutions that provide capital in exchange for equity in their businesses.

Some parts of the world are still in phase 1, other parts are in phase 2 because there weren't enough resources to complete phase 1, or government stimulus is running dry.

Opportunities and challenges for the capital markets industry

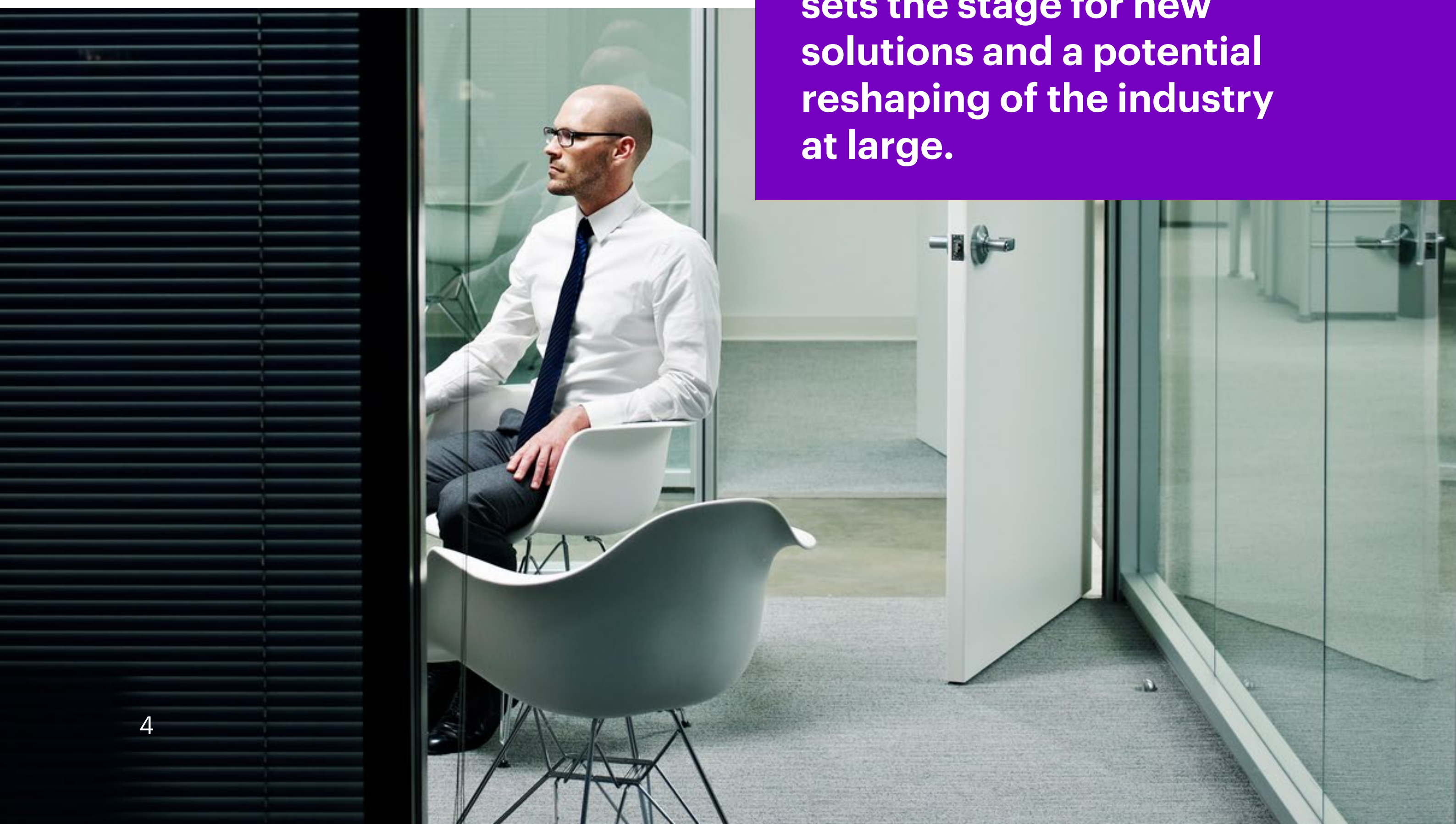
Within the second and third phases of the looming credit crisis, capital markets firms could face the challenge of developing solutions to meet the demands of the moment.

They would be asked to quickly address the urgent needs of companies that may be smaller than those that usually sell stocks and bonds in public markets, and also to develop a greater footprint in emerging markets.

The new nature of this problem and the lack of a pre-existing infrastructure poses a challenge that would draw on the talents and willingness of participants to step up and try innovative solutions—which need to be replicable at large scale—to aggregate capital for a diverse and unfamiliar source of demand.

While phases 2 and 3 could be replete with novel risks, they also offer potential rewards for the industry. The need for liquidity is going to be intense, and as these phases play out, the economic backdrop may become more perilous. Difficult questions about taxes, regulations, accounting, overseas markets and the law would affect the valuations assigned to these deals by bankers, underwriters and investors. Yet, for all those difficulties, a constructive response to this challenge could help redefine the public perception of the capital markets for years to come and could also provide new potential sources of return for yield-starved investors. But what do firms need to do?

Extra stress in the corporate sector could easily translate into pressure on the capital markets sector—but it also sets the stage for new solutions and a potential reshaping of the industry at large.



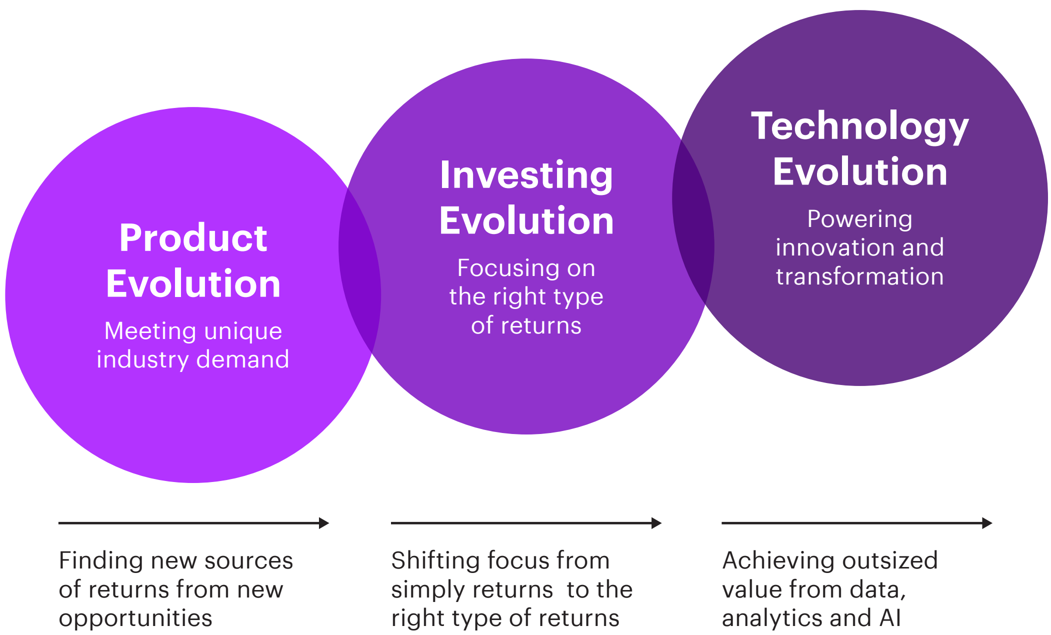
Innovating product offerings as a key opportunity for the industry

Mushrooming credit problems present capital market firms with an opportunity to grow revenue and reach small- and medium-sized businesses whose financing needs have historically been met by commercial banks. These smaller businesses, which are being hit especially hard by the looming crisis, have traditionally been shut out of the stock and bond markets because of their size. There is a growth opportunity in meeting the funding needs of these companies by creating securities and financing structures that would also satisfy the risk appetites of investors.

Such innovations are the hallmark of the financial industry, including the creation of mortgage bonds in the 1980s, and later asset-backed lending, collateralized loan obligations and other opportunities for investors that have directed capital to the enterprises that need it. A significant percentage of these smaller businesses should be able to rebound if they can raise enough money to carry them until growth resumes.[3] These companies present an opportunity for investors at a time when the flood of support from global central banks has pushed equity valuations to historically high levels while pulling bond yields to record lows. Securities firms have the tools they need to grow revenue by building products to service smaller and mid-sized businesses. Firms that can create vehicles to fund smaller companies could also have an advantage in distributing these products and meeting the needs of their asset management clients.

- The **bond market** has long sold debt securities repaid with pooled revenues from credit cards or auto loans. Securities firms could take creative approaches to aggregating revenue pools from small businesses, grouping them by industry or geographical region. Equity investors could purchase shares of pooled small businesses bundled into publicly traded exchange-traded funds.

Capital markets: Continuing to rise to the challenge



Source: Accenture Research

- **Underwriters** could pool shares or loans of businesses that are environmentally sound, play important social roles or are committed to strong corporate governance, meeting important priorities for investors who seek to fund these kinds of companies. Investments could be pooled to target minority-owned companies, for example.

The growth in recent years of environmental, social and corporate governance (ESG) investing, where investors allocate capital with the goal of supporting companies that are taking steps related to improve outcomes related to the environment, social justice and corporate governance, suggests that meeting the needs of smaller firms amid a credit crisis could drive gains in revenue. This sector is small, yet it has grown rapidly, and is taking off as COVID-19 has pushed forward questions about how investments affect conditions in the broader society. The opportunity for revenue growth dovetails with the societal benefit of supporting sustainability and an equitable culture.

The rapidly advancing areas of data and analytics will play a key role in the process of innovating. Firms should be asking how data and analytics can be used to fuel innovation, address lingering problems and understand and navigate the changing marketplace. As technological advances lead to accelerating innovation, firms need to push forward on projects currently stuck on the drawing board, but which could add revenue and meet the needs of customers in the current environment. There are several ways that data and analytics can help firms innovate and navigate through the crisis. As the pace of technological innovation accelerates, capital markets firms have the opportunity to help clients by martialing their vast access to information and their ability to sift it in ways that improve the relationship between risks and rewards in their decision-making. And by filling a widening funding gap faced by smaller businesses, capital markets firms can pair revenue growth with fulfilling an important societal need at a crucial time.

Bringing analytics to life in capital markets

	Example	Taking it further
Investment Decisions	Analytics can capture sudden changes in the willingness of consumer and business travelers to book flights. Data gathered can help forecast an airline's earnings, cash flow and balance sheet, or develop a more detailed outlook for the broader industry.	Data trends from one industry can be used to find correlations and linkages with other sectors. This analysis could inform a deeper assessment, i.e. whether changes are contained within one part of the economy or part of a broader change.
Mergers & Acquisitions	Firms can give better advice in supporting potential mergers and acquisitions, and more effectively analyzing data. For example, data could illustrate how effective customer retention efforts may be, whether margins could be improved or if relationships with suppliers, customers or employees could be enhanced.	Advanced analytics could signal whether an industry's pricing models or operating assumptions are fundamentally broken; where additional capital can be spent most efficiently; or help identify additional risks surfacing in real-time.

Developing the next generation operating model as the challenge for the industry

COVID-19 isn't a discrete event that will be remembered only in case studies. Just as it has forced firms to accelerate their use of technology to grow revenue, it is also forcing companies to work harder to cut costs. Many of these cuts were necessary before the pandemic, but in its wake, they have taken on additional urgency. The industry's efforts to grapple with COVID-19 have already made it impossible to return to the old status quo. Overall, firms should take an especially critical eye to the following operating model considerations.

Footprint, outsourcing, and future of work

One enduring change brought by COVID-19 is likely to be a new thinking about a company's appropriate footprint. For many players within the capital markets, their businesses—and by extension, their client service capabilities—pivoted virtually almost overnight. This arrangement was unheard of, and firms rightly worried about the adjustment from an operations, technology and employee contribution perspective. According to our recent Return to Work survey, we found they needn't be so concerned: capital markets players realized an 11%–15% median increase in both productivity and efficiency for those who experienced a gain (see below).

The need for employees to be located in the main office, in-person for five days per week has shifted. With many people able and sometimes even wanting to work from home, companies should seek the best balances between remote working capacity with the need to meet and organize around centralized locations.

Productivity and efficiency gains

Most CIO and COO respondents have observed productivity and efficiency gains with the shift to remote work according to a recent Accenture survey in capital markets.

Technology

More than 50% of CIOs report gains in productivity and/or efficiency with the shift to remote work—in most cases, less than 15% saw their metrics deteriorate.

▼ 13%

9% to 19% saw a decrease, depending on the functional area

▲ 60%

53% to 66% saw an increase, depending on the functional area

16–20%

Median increase in both **productivity** and **efficiency**, for those who experienced a gain

Operations

Similarly, most COOs reported gains across most areas,* while 20% or less reported negative effects.

▼ 18%

8% to 43% saw a decrease, depending on the functional area

▲ 52%

20% to 74% saw an increase, depending on the functional area

11–15%

Median increase in both **productivity** and **efficiency**, for those who experienced a gain

*Capital markets client onboarding being the primary exception

Source: Accenture Research, 2020

This could reduce the amount of office space needed, providing firms with a cost-cutting opportunity. Executives should examine exactly what work needs to be done from the office, and whether that location needs to be in an expensive headquarters building or whether it can be moved to lower-cost locations. Further, the expansion of remote work creates opportunities to re-invent what work looks like. With the disruption of face time, can firms further improve their cost profile and access to talent by offering more flexible hours or part time models?

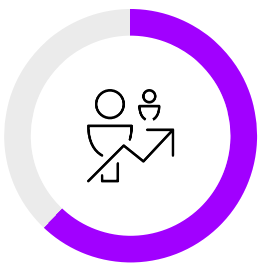
Firms can also refine their operating models by outsourcing tasks which are commodified and lack revenue-generating opportunities which add value. While many firms have pulled this lever or are considering it—85% of asset management firms have already outsourced their trading desks or are interested in doing so in the next few years—it's still vitally important for those who haven't. Data management is an area ripe for outsourcing, with nearly half (45%) the firms in a Northern Trust survey planning that move in the next two years; approximately one-third are considering outsourcing foreign exchange and middle office functions.[4] Operating model re-thinks should also re-raise the question of where cross-industry utilities could lower costs and help firms to focus on profit-generating activities. One example of this is Accenture's Post-Trade Processing solution that, on the back of Broadridge's technology, is set up to mutualize investment banks' expenses and activities across several institutions, and to help to better adapt to regulations and developments in market technology.

Firms mostly adapted to virtual first better than expected, so the question becomes, what does this mean for the footprint of the industry going forward?

If we can function well outside the office, will we ever return? And if we do, what will it look like?

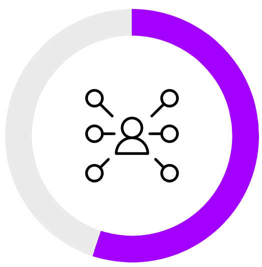
73%

of CHRO respondents believe **remote working** is sustainable long-term



62%

of CIO/COO respondents that have seen **productivity/efficiency gains** believe some or all gains are permanently sustainable



55%

are planning to deploy **a physical, digital, and hybrid workforce** and location strategy that allows for maximum flexibility and employee choice

42%

are planning to **reduce their real estate/office footprint** as a result of their planned **workforce and location strategy**

Source: Accenture Research, 2020

Accelerate digital transformation

As capital markets firms grapple with the economic fallout and waning government support amid future iterations of the response to COVID-19, improving their operating models with next-gen tools, such as AI, should become a priority. Managers should identify which data and analytics tools are needed to support innovation and make sense of markets that are responding to economic events that are so unlike conventional business cycles. Capital markets companies can learn from banks that had succeeded in shifting processes to the cloud, improving data management while lowering costs. Such moves facilitate the acceleration of projects using AI to innovate, pulling forward long-term goals so that they're attainable much sooner. Here are some ways new technology could improve operating models:

- Accelerating the migration of data and operations to the cloud lowers costs while increasing flexibility for modernizing and expanding services. The cloud provides on-demand scalability, making it ideal for developing new products and services, as well as data analysis and storage. Migrating to the cloud can facilitate growth as well as cost cutting, according to Accenture's recent perspective, "The new cloud imperative in capital markets." With an estimated 5% to 10% of the industry's technology solutions on the public cloud, there are many opportunities for further migration.[5]

- Accelerating the use of AI to re-invent call centers in retail environments, facilitate client onboarding and improve internal reconciliations—a perennial pain point within the industry—can both save costs and improve user experiences.

- Next-generation technology gives firms the capacity to improve or re-invent functions such as client servicing. In the wealth industry, a potential application would be to more broadly leverage an automated paraplanner so that financial advisors can dedicate their attention to relationship-building and select portfolio decisions.

For the wealth management industry, Accenture just published a new report looking into how AI is applied today in the industry and ways to scale the use of this technology.[6]

Leverage industry scale

Many analysts anticipate a wave of consolidation within the capital markets, particularly among asset management companies where scale can be an important lever for reducing costs and boosting profitability. The benefits of these combinations for customers and shareholders remain dependent on execution.[7] Recessions are often an opportunity to snare a productive asset at an attractive price—however, this time truly is different. In the recession following the financial crisis in 2008, concerns about the economy drove financial firm valuations to extraordinary lows. Now, unprecedented central bank liquidity has lifted valuations in defiance of historical standard.[8] It's likely that at some point, stock prices could more closely reflect economic output. It would be prudent to factor in these risks when weighing opportunities.

COVID-19's impact should lead companies to hone their strategy and narrow their approach to M&A. Many fintech companies have seen their prospects darkened as the persistence of the current events has hurt their ability to access new funding. Established firms should seek acquisitions which could augment or jump-start their capabilities at lower costs than building from within.

Companies should also take a hard look at which business lines they excel at versus those that are ancillary. The COVID-19 recession presents an opportunity for firms to simplify operations and focus on core capabilities, leading to lower expenses. Having identified where they create the most value, firms should focus on scaling up these operations. Global firms may approach the question from a geographic perspective, tightening their focus on regions where they have the greatest potential.

Moving forward

COVID-19 has made it impossible for firms to maintain the status quo.

It's clear that innovation is a precondition not just for profitability but for survival. At this moment, there's a need for new products to meet the requirements of small- and medium-sized businesses that would increasingly need help from the capital markets. Is there a sector where you have conviction about how to address dislocations or broken business models? Finding ways to help this sector could drive revenue growth by revealing an untapped market. At the same time, it can create the capacity to distribute new growth and income products to investors searching for alternatives to securities issued by larger, more established businesses that sport elevated valuations.

Capital markets firms are facing unprecedented challenges, at the same time liquidity from global central banks is providing markets with stability. Even amid a global recession, companies in the securities industry have some cushion to improve their operating models. They can accelerate work on digital and cloud projects, or test schedules where workers come to the office just once a week.

The rapid transition to working remotely amid the pandemic has sped the pace of innovation: challenge your teams to identify an initiative that once might have taken years but can now be compressed into three months. This is a moment where you have an opportunity to take bold steps. It's also a period where the industry is transforming itself. That means complacency isn't an option and that innovations which can create revenue or cut costs are, in fact, a necessity.

References

[1] https://www.wsj.com/articles/private-equitys-trillion-dollar-piggy-bank-holds-little-for-struggling-companies-11593212136

[2] https://www.theguardian.com/world/2020/dec/16/bad-loans-of-banks-risking-credit-crunch-warns-european-commission

[3] https://www.imf.org/en/Topics/imf-and-covid19/Policy-Responses-to-COVID-19

[4] https://www.northerntrust.com/united-states/pr/2020/survey-asset-mangers-most-concerned-about-managing

[5] https://www.accenture.com/us-en/insights/capital-markets/cloud-imperative-capital-markets

[6] https://www.accenture.com/us-en/insights/capital-markets/wealth-management-artificial-intelligence

[7] https://www.institutionalassetmanager.co.uk/2020/10/14/290851/wave-consolidation-asset-management-expected-increase-pressure-squeezed-mid-size

[8] https://www.barrons.com/articles/the-fed-stays-the-course-dont-expect-it-to-end-its-massive-asset-support-anytime-soon-51608161531

Contacts

Michael Spellacy
Senior Managing Director
Global Capital Markets Lead
michael.spellacy@accenture.com

Nicole Bodack
Managing Director
Capital Markets, Growth Markets Lead
nicole.bodack@accenture.com

Matt Long
Managing Director
Capital Markets, Europe Lead
matthew.j.long@accenture.com

Laurie McGraw
Managing Director
Capital Markets, North America Lead
laurie.a.mcgraw@accenture.com

Soichiro Muto
Managing Director
Capital Markets, Growth Markets Lead
soichiro.muto@accenture.com

Kimberly Richards
Managing Director
Banking and Capital Markets Strategy
kimberly.richards@accenture.com

Matthew Haggerty
Manager, Capital Markets Research
matthew.j.haggerty@accenture.com

Stay Connected

Explore more Capital Markets Latest Thinking

Read our Capital Markets Blog

Follow us @AccentureCapMkt

About Accenture

Accenture is a global professional services company with leading capabilities in digital, cloud and security. Combining unmatched experience and specialized skills across more than 40 industries, we offer Strategy and Consulting, Interactive, Technology and Operations services—all powered by the world's largest network of Advanced Technology and Intelligent Operations centers. Our 514,000 people deliver on the promise of technology and human ingenuity every day, serving clients in more than 120 countries. We embrace the power of change to create value and shared success for our clients, people, shareholders, partners and communities. Visit us at **www.accenture.com**

201047