CAPCO

LESSONS FROM THE PANDEMIC

SHORT TERM MEASURES IN FINANCE NEED TO BECOME SUSTAINABLE FOR THE 'NEW NORMAL'

INTRO

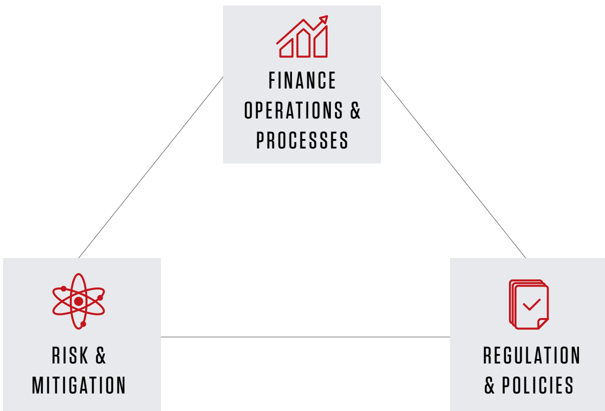
From the beginning of the global COVID-19 pandemic nearly two years ago, many companies had to react quickly to survive, with Finance departments put firmly in the spotlight during the crisis. Although it is beginning to look like the return to the pre-pandemic times, some changes will remain going forward and need to be adopted in a more sustainable way. This paper discusses lessons learned from the COVID-19 crisis for the CFOs and their Finance departments, including their subdivisions – Treasury, Controlling and Financial Planning & Analysis (FP&A).

CHALLENGES FOR THE FINANCE DEPARTMENT AS A WHOLE

The COVID-19 crisis has put the corporate function of Finance into the spotlight, as the department had to react quickly to the pandemic developments and government measures. As the return to pre-crisis scenarios is looking likely in many geographies, adapting to the new normal will combine the current crisis and the pre-crisis setups.

From the start of the pandemic, many Finance departments had to change their setup and processes to deal with governmental directives (or at least recommendations) to move **Finance operations** into a 'home office' mode. Existing processes had to be adapted in a 'quick and dirty' way (e.g., scanning of documents and distribution by email for approval) to ensure the core functionalities of Finance continued in the new setup.

Managing **risk** remains a top priority for any Finance department, however it has become increasingly more challenging in the pandemic. Also, the home office setup has heightened (and will continue to do so, compared to the pre-pandemic times) the cyberattack and fraud risks, as the infrastructure at home might be more vulnerable compared to the corporate setup. According to a recent study, cyberattacks with focus on invoice and payment fraud to companies have increased by 200 percent in April/May 2020 at the peak of the first wave of the crisis[1]. One might argue that this is true for all corporate functions in a firm, however due to Finance being close to funds and data, the function is much more exposed and a lucrative target for cyber fraudsters.



1. https://www.helpnetsecurity.com/2020/06/30/payment-fraud-bec-attacks/

Government **regulations** had been partially eased by regulatory bodies (e.g., the Swiss regulator released updated requirements for a brief period), but after the summer of 2020 regulations returned to the pre-crisis state (and are likely to continue in the same pace) in several European jurisdictions including Switzerland. **Internal policies** have been temporarily waived to cope with the situation, but not yet fully reversed, causing additional risks for companies. However, we are not yet seeing a reflection in internal policies of the setup that is most likely to continue going forward. This is largely due to the fact that companies have been waiting for the crisis to end.

In addition to the increased risk of fraud, **operational risks** have been increasing for Finance processes, especially where they have not been (fully) automated and require manual coordination and communication between functions and people (e.g., several people working within the same Excel file for planning purposes). Whereas in an office setup, staff will coordinate their actions while sharing the same space, home working requires much better coordination and alerts to maintain consistent results.

Subdivisions such as Treasury, Controlling and FP&A face additional specific challenges which we will look at in the following sections.

CHALLENGES FOR TREASURY DEPARTMENTS

Treasury is responsible for ensuring the solvency of the company through efficient foreign exchange, funding and liquidity management. In 'normal' times, it remains a relatively invisible function within the company, only attracting the C-suite attention by C-levels in cases of operative failures. COVID-19 has highlighted the importance of the Treasury function for companies.

In addition to getting increased attention from senior executives, Treasuries found themselves in turbulent times, challenged by a highly increased workload, intensified with a more volatile home office setup and local lockdowns, particularly at the beginning of the crisis.

Specifically, the conventional way of forecasting **cashflows** and managing **liquidity** had to be adopted in an agile way because of extreme changes in cashflows, caused by the strong underlying changes in many businesses (e.g., airlines) and related assumptions based on past pre-crisis experience. Depending on the business model of the underlying company, the crisis had a strong impact and created high volatility in cashflows, in some cases emphasized by certain catchup effects later (e.g., automotive industry slowed down again later due to supply chain issues).

Corporates and financial institutions had to quickly prepare and adapt to government support programs from a process perspective to protect their business early in the crisis or to support these programs. For companies not eligible for support programs (or where support programs were not deemed as sufficient), the volatility of markets during certain periods demonstrated the utmost importance of emphasizing the concept of diversification.

Some funding markets were not accessible or only at a significant higher cost, especially as companies were already under pressure due to strong business declines. This had an immense impact on the **capital & funding** of treasuries, corporates and financial institutions. But there were also new phenomena - private banks, for example, were flooded by cash due to lower consumption by individuals as well as certain investments being put on hold in turbulent times.

In the post-COVID environment, indicators are showing tendencies of inflation which has only slight effects of higher yields for upcoming funding so far, even if central banks such as the European Central Bank (ECB) or the Swiss National Bank (SNB) have not reacted significantly to this.

CHALLENGES FOR CONTROLLING AND FP&A DEPARTMENTS

Similar to the Treasury function, Controlling teams were also challenged by the dynamic environment in **forecasting** revenues and expenses in order to steer the company financially through the crisis. Due to the high external volatility in many markets and related issues (e.g. sourcing of supplies due to disrupted logistics globally), CFOs and their Controlling teams were only able to provide effective financial steer on a short term basis.

Supply chain management has faced major challenges with unpredictable demand for certain products, along with travel and production constraints. Major supply chain optimization geared toward minimizing costs and reducing inventory has led to the disappearance of buffers and the flexibility needed to absorb disruptions, worsened by overordering to get a pro-rata supply and overall making sales planning very difficult.

Many previously proven patterns for forecasting turned out to be ineffective and new ways of forecasting and reporting had to be developed, while data availability real-time (or close to real-time) as a pre-requisite had been a known challenge for many industries since before the pandemic.

The good news is that technology is rapidly evolving. New supply chain technologies enable businesses to become more resilient in times of crisis and are designed to bring significant benefits, both in terms of process and cost optimization.

LESSONS LEARNED AND ACTION POINTS GOING FORWARD

Operations teams must revise BCPs: At the start of the crisis Finance departments needed to revise their existing business-continuity planning in terms of geographic locations and backup plans for their staff in case of unavailability due to lockdown or illness. Going forward, emphasis should be given to certain backup opportunities across countries and specific teams (e.g., front, middle and back office functions). This could mean for smaller teams (for example, Treasury) that other Finance functions (e.g., Accounting) might be acting as backup for the back office Treasury function. But also, for bigger teams, interfaces between Finance functions such as Accounting or Controlling / FP&A should be carefully analysed and potentially improved.

Home office adds new challenges: To address the increased risks arising from home office working, which is expected to remain to a certain extent going forward, CFOs must adapt the current target operating model and also revise existing policies with regards to governance, processes and approval powers to be maintained, to accurately reflect the new challenges and increased complexity.

Automation is necessary for process improvement: Ideally, this should be combined with process review and tool support. Also, existing, mostly manual workflows should be properly digitalized and automated (e.g., via RPA) to reduce cyber and operational risks going forward as outlined in the previous section. Automation will also help with process improvement while achieving cost savings and reducing operational inefficiencies, thus improving both risk and costs in one shot.

Planning needs to become agile: In addition, mainly Treasuries and Controlling functions need to rethink their processes and assumptions of their current planning. Assumptions from the past can change drastically during a crisis and processes must become much more agile to reflect such immediate changes in the short term. To enable a suitable, more agile setup, underlying data must be available quickly, on time and in an automated way, and the companies must be able to get a daily view on their liquidity position for planning purposes in Treasury or an improved gap analysis for FP&A.

Based on AI solutions, forecasts could become more dynamic/ less static, especially when underlying patterns change drastically. Here it is also appropriate to mention the capabilities of modern artificial intelligence and machine learning methods for the task of big data volatility modeling. Forecasting future values of liquidity ratios is nothing but the task of finding patterns of seasonal fluctuations, trends and outliers in the time series and extrapolating those. Many companies are also progressing their Finance applications to the cloud to take advantage of cloud's standardized tools and performance.

Don't forget the 'black swan': Based on the experiences of liquidity and cashflows, Treasuries need to revise their internal stress test scenarios now (or create from scratch if they had not existing before the crisis), not only to address the unexpected and unknown future circumstances but also to rethink for the most unimaginable black swan[2] events and be prepared on time, ensuring that current weaknesses in the setup are detected and mitigated early to the extent possible. Even if new black swan scenarios are not realistic and – prior to the COVID crisis – such a scenario might have been not modeled at all, it creates a certain mindset and a new perspective, which would help trigger in-depth reviews of existing setups for certain risks.

Funding needs diversification: With regard to funding and capital, companies must continue to diversify their funding and sources of capital to overcome issues that arise when certain funding markets are temporarily inaccessible or only at a significant cost. The mix of equity and debt (respective to the corresponding ratios for banks) should consider some buffers for more turbulent times. Again, this is not a new finding, but its relevance has been highlighted during the crisis.

Finally, as we now hope to be nearer the end of the COVID-19 crisis, all stakeholders need to prepare to enter the next stage of the new normal. We can expect that it will be a continuous flow that combines the current crisis setup with the pre-crisis setup.

2. https://www.forbes.com/sites/johndrake/2021/11/11/was-covid-19-a-black-swan-event/?sh=396a7872bd36

SUMMARY

From the beginning of the pandemic, the global home-office trend has brought a considerable number of challenges for Finance departments. However, the crisis also accelerated significant opportunities to overcome existing issues in Finance that have not been tackled due to higher priorities on the change agenda.

Greater workloads, increased volatility, data quality issues and only partially adopted processes are just some of the problems that need to be addressed. In addition, issues around forecasting and planning present fresh challenges for CFOs. Here, artificial intelligence tools can help adapt to a changing and dynamic environment, providing more accurate forecasting.

The most vulnerable area is the increased operational exposure caused by remote working of Finance departments. This issue must be properly addressed by adopting internal policies to the changing regulatory requirements, providing more agile resource planning, and, where possible, using automation tools. Automation and the reduction of manual data processing are the key components for minimizing cyber and fraud risks and providing additional efficiencies, and now is the ideal time to introduce or improve automation that has been sitting on the CFO agenda for a long time.

Considering that we are now hopefully at the end of the COVID-19 crisis, the Treasury function is also going to play a more significant and visible role in solving the above-referred problems than before the pandemic. To improve forecasting, Treasury departments should adjust their liquidity and cashflow stress testing models taking into consideration instant fluctuations in cashflows. For these purposes, reporting on, for example, financial liquidity status should be available at the touch of a button. Such approach would allow Treasuries to be more prepared for unforeseeable events and to better understand weaknesses in their liquidity positions.

HOW CAPCO CAN HELP YOU

Drawing upon the latest industry trends and guided by our domain-led vision of Finance, Capco will help you transform your business post-COVID-19 to ensure long-term profitability and provide additional value propositions via optimized processes and automation through digitalization.

Capco can support you across all stages of your Finance transformation – from creating an initial strategy and target operating model through to operational transformation, including process automation and digitalization, and finally the management of these initiatives.

With our experienced SMEs and our deep expertise in financial solutions, both in the Swiss and global markets, Capco will guide you on your journey to the future of Finance.

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ABOUT CAPCO

Capco, a Wipro company, is a global technology and management consultancy specializing in driving digital transformation in the financial services industry. With a growing client portfolio comprising of over 100 global organizations, Capco operates at the intersection of business and technology by combining innovative thinking with unrivalled industry knowledge to deliver end-to-end data-driven solutions and fast-track digital initiatives for banking and payments, capital markets, wealth and asset management, insurance, and the energy sector. Capco's cutting-edge ingenuity is brought to life through its Innovation Labs and award-winning Be Yourself At Work culture and diverse talent.

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