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## **COVID-19 Impact on Gambling and Banking: A Comparison**

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**Abstract:**

**Purpose:** *The gambling industry has been slowly shifting to online as more jurisdictions are allowing for online betting. The effect of the COVID-19 pandemic has accelerated the growth of online competitors but what can participants bet on if there are no sports events? Moreover the set-up of this industry has been also disrupted by the COVID-19 pandemic. In this paper, we discuss the impact of the pandemic on the gambling and the banking industry.*

**Design/Methodology/Approach:** *We interview 21 professionals based in Malta, an EU country which is considered as a hub for operations of online gambling operators.*

**Findings:** *Despite serving different aims, they share some similarities as both operate in highly regulated environments. We find that COVID-19 has been acting as a catalyst for both industries to accelerate changes.*

**Originality:** *The gaming industry is a multi-billion euro industry but there are few academic discussions focusing on their operations. Our paper is unique in focusing on the challenges of this industry during the pandemic*

**Keywords:** *Gambling, covid-19, operational risk, banking, esports.*

**JEL codes:** *O31, O32.*

**Paper type:** *A research article.*

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## 1. Introduction

COVID-19 brought unprecedented and uncertain times on the world, and many businesses had their revenues impacted coupled with heightened risk levels (Grima *et al.*, 2020; Khan *et al.*, 2020). However some business have benefited from the pandemic as people stuck at home had to change their behaviour. For example the share price of Zoom, a web conferencing service, shot up dramatically (Waters, 2020) and online retailers flourished (Roggeveen and Sethuraman, 2020). Even within the same industry, different corporations have had adverse results such as the bad results for insurers that cover event cancellation and the short-term benefit for motor insurers as lockdown reduced risk exposure (Tamturk, Cortis, and Farrell, 2020).

An industry that may have benefitted from the pandemic is the online gambling (gaming) industry<sup>2</sup>. As the first wave of the pandemic was engulfing Europe, we starting examining the effect of this industry when compared to the traditional industry of banking in Malta. Malta is a small archipelago in the middle of the Mediterranean Sea with about half a million citizens. Despite its small size, a significant number of iGaming companies are registered and operate in Malta. For example, there are eight English Premier League soccer teams in the current season (2020/21) whose main sponsor is a gambling firm – and three of these are registered in Malta<sup>3</sup>. Malta had a first mover advantage in setting up one of the first comprehensive gaming acts that can cater for online betting and the gaming industry. As a European Union member, gaming companies based in Malta could easily passport their services to other European countries. This has resulted in the gaming industry contributing to over 10% of Maltese Gross Domestic Product (GDP) (Malta Gaming Authority, 2019).

Apart from the regulation aspect, Malta is a preferred hub to operate from, having industry heavyweights based in Malta, due to the investment made by the government in the iGaming industry (Malta Gaming Authority, 2018). The banking industry in Malta is fairly traditional with six core domestic banks that have about €25 billion in assets. We envisaged that a research comparing the effects of COVID-19 on these two industries would be a beneficial exercise as would result in being able to draw-down comparisons and contrasts between the two. The banking and iGaming industries face many similar risks. They both operate in heavily regulated customer-oriented industries where liquidity and solvency are crucial to their operations.

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<sup>2</sup>Most regulators worldwide (for example New Jersey Division of Gaming Enforcement) use the term gaming despite focusing on casinos, poker, slots and sports betting. We are using the terms interchangeably throughout this text.

<sup>3</sup>LoveBet, Betway and ManBetX are main shirt sponsors for Burnley, West Ham United and Wolverhampton Wanderers.

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The banking and iGaming companies in Malta witnessed such repercussions, with various existing risks having an increase in the likelihood of occurring and severity of the impact. This research demonstrates the effects of COVID-19 in terms of both risks and profitability, and also the changes which both industries had to make to adapt to such phenomenon, which is where business continuity planning and agility come into play.

## **2. Literature Review**

The International Risk Governance Council (IRGC) defines emerging risks as “new risks or familiar risks that become apparent in new or unfamiliar conditions.” (IRGC, 2015). Emerging risks can be man-made, natural, or both, and may be brought about by technological, economic, societal, environmental, regulatory, or political change. Emerging risks may be unknown, with unclear potential severity or changing over time. Therefore, it is important for early detection and to instil a risk culture to identify how a bank or an iGaming company may be impacted by an emerging risk. This ties in with Enterprise Risk Management (ERM) as part of a holistic approach to managing risks, not only for established risks, but also for those which may have just developed or might be significant in the future (Weymann and Egloff, 2018).

A pandemic is a risk which has a low probability of occurring but a large impact. It can be both catastrophic and global, whereby economic losses severely affect global GDP. The effects of a pandemic include economic downturn due to shifts in demand, supply shocks, and economic and social disruptions. Since countries are interconnected due to travel, trade and capital movements, downturns easily spread to different economies and financial systems around the world. Although these risks are anticipated, the level of impact and evolution of the risk is unpredictable (Jonas, 2013). This is evidenced in the effects of COVID-19, which can be classified as an emerging risk, with consequences which are fast-developing and devastating.

The COVID-19 pandemic is an emerging risk for banks and iGaming companies. COVID-19 aggravated the day-to-day risks by increasing their probability of occurring and the severity of their impact. Restrictive measures by governments have led to a synchronised collapse in economic activity across the world. What started as a health crisis in one part of the world, has led to a worldwide economic crisis. Companies have to deal with two types of risks in the face of Covid-19; financial risk manifested in the loss of liquidity and reduction in financial assets, as well as increased operational risks due to failure of resources which disrupt normal operations (such as people, processes and technology). The criticality of business continuity plans is shown in their effectiveness to reduce the impact of this emerging risk (Coelho and Prenio, 2020; Johnson, 2020).

Risks arising from the onset of COVID-19 in the banking industry include stress on their loan portfolios, unfavourable solvency positions, loss of confidence in banks

from their customers, and panic leading to bank runs. In risk terms, the COVID-19 pandemic is the manifestation of systemic risk in the banking industry not only in Malta but also in the EU (Baldwin and Mauro, 2020). Banks and other types of companies experienced deteriorating performance at the initial outbreak of COVID-19, with other companies recovering later on throughout 2020. However, banks' recovery was not as successful, which indicates that banks had to absorb losses incurred by other companies (Demirguc-Kunt, 2020).

The iGaming industry witnessed a shift in the gambling patterns due to COVID-19 (Håkansson *et al.*, 2020) due to more time spent at home and online. Furthermore, due to cancellations of major sporting events, betting on these events ceased. iGaming companies' revenues and solvency position became at risk by these cancellations, however, one could observe an increase in other gambling types, such as online casino. COVID-19 further aggregates financial and operational risks, by increasing the risk of managing problem-gambling behaviour (Håkansson, 2020).

### **3. Research Methodology**

*Primary data collection: semi-structured interviews:*

Key market players were asked for an interview or meeting which entailed pre-set questions revolving around the research topics. The flexibility aspect was achieved by adapting the questions asked based on the responses given during the interview, allowing for a more open discussion, a better understanding of the interviewee's opinion (Saunders *et al.*, 2016) and what the interviewee considers as more crucial.

Face-to-face interviews were carried out in February 2020, however, due to the deteriorating scenario of COVID-19 in Malta, the researcher had to adapt accordingly from March 2020 onwards. All interviewees declined face-to-face interviews and offered to carry out online interviews. For this purpose, several platforms were used, namely Skype, Zoom, Microsoft Teams, Webex and Whatsapp.

*Establishing the interviewees:*

To effectively carry out research and have accurate results, a balance between banking and iGaming respondents needed to be kept. In fact, this study has an equal number of respondents per industry. At first, the author started with the banks and iGaming companies, and then proceeded to inviting other market players.

Emails inviting banking respondents were sent to the majority of banks operating in Malta through an email sent via the Malta Bankers' Association to its members. This ensured that different types of banks were targeted, namely:

1. Core Domestic Banks / Systemically Important Institutions.
2. Non-Core Domestic Banks.
3. Foreign banks.

This ensured that the full picture of the Maltese banking scenario was captured. Furthermore, individual emails to Chief Risk Officers and other high-ranking employees were also sent, in order to ensure that replies from people at the helm of risk management are obtained.

A slightly different approach was undertaken for iGaming companies, whereby emails to a large number of operators comprising the majority of Gross Gambling Revenue in Malta were sent. Emails were either sent to generic email addresses, or else to contacts obtained through the researchers' colleagues. The majority of respondents work in the risk and compliance function, with most of them occupying top positions. The largest and most prominent iGaming companies based in Malta were preferred, as opposed to start-ups and small companies.

The next step involved asking other respondents, such as the regulatory authority of the respective industry, namely the Malta Financial Services Authority and the Malta Gaming Authority; the Central Bank of Malta as a supervisory function. To obtain a more generic overview of the respective markets, invites were also sent to advisory and audit firms, including the Big 4 and others.

An important element of the latter respondents is that they could compare and contrast the two industries since they have exposure to both. Moreover, other individuals who have experience in both industries were also asked to contribute to the study for the sake of a better comparison and more in-depth analysis. The roles of the interviewees include senior officials, managerial staff, heads, chiefs, and directors. The following table outlines the number of interviewees by type of respondent mentioned in this section:

*Table 1. Number of interviewees by type of respondent*

<b>Type of respondent</b>	<b>Number of interviewees</b>
Bank	5
iGaming company	7
Regulatory Authority/Government Agency	3
Audit & Advisory Firms	5 (4 of which being Big 4 companies)
Other experienced people	1

*Source: Own study.*

#### *Analysis of data:*

The data gathered from the interviews was then filtered and analysed. Particular attention was not only given to the points and issues which were mentioned by various respondents, but to unique responses which also provided valid insight to the research area. The researcher was thus able to identify similarities and differences in the responses, as well as identify trends, prospects, and recommendations by the respondents.

#### 4. Results and Discussion

##### *Banking Specific Risks:*

The pandemic made its way to the top risks which banks are facing as stated by the majority of respondents. The ramifications of COVID-19 are aggregated as banks are still facing various risks in their day-to-day operations; however, COVID-19 is another risk, which although many banks have stress-tested on, its impact level is unforeseen. COVID-19 aggravated the day-to-day risks by increasing their probability of occurring and the severity of their impact. Restrictive measures by governments have led to a synchronised downfall in economic activity across the world. Even though, COVID-19 started in one part of the world, the pandemic itself and the risks arising from it, are felt globally. Respondents confirmed that in risk terms, the COVID-19 pandemic can be classified as a systemic risk in the banking industry, due to the interconnectedness of the industry to other industries.

Since many people and companies have suffered a reduction in revenue and earnings, many of the banks' customers are not able to repay their loans. One of the banking respondents stated that Maltese banks are forecasting an increase in Non-Performing Loans but the impact is forecasted to be less than their EU counterparts, partially due to the higher solvency margins maintained by Maltese banks, lower amount of risky derivatives and trades owned by the banks, and the relative resilience of the local economy.

Banking respondents confirmed that Maltese banks are exposed to property, in view that it serves as a collateral when individuals and businesses take out a loan; which is especially typical in Malta. The onset of COVID-19 means that banks with a large exposure to the property-market would have an adverse impact as they could potentially end up with an oversupply of seized property. Another related risk arises from the local rental market, with many foreigners being repatriated, lower holiday rentals<sup>4</sup> and locals having less income, could result in an oversupply of rental property in the market. This indirectly affects Maltese banks who give loans on property to let as these customers would be unable to repay their loan. Banking respondents also confirmed that their commercial and corporate portfolio would suffer by the decline in tourism and leisure industries, which form a good part of the Maltese economy and of banks' clients.

Some respondents said that today's banks have never experienced a pandemic with such a large impact before. Although there were pandemics in the past, these did not cause the same devastating effects globally. More specifically, banks were not prepared to handle a risk event on such a large scale, with the unforeseen aspect being the increased impact from industries they are most exposed to. Respondents said that in December 2019, the Central Bank of Malta commissioned a survey asking all Maltese banks to identify the top risks which could lead to the next

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<sup>4</sup>Approximately 17% of GDP is reliant on the tourism sector in Malta (Grech et al., 2020).

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economic recession. Pandemic risk did not feature in the top ten list, but cyber and geo-political risks did.

*iGaming companies' specific risks:*

Since customers of iGaming companies in Malta include residents in other countries, this means that the negative effect is of a larger magnitude if players reside in countries which are worse-hit than Malta. When players have no income due to unemployment, they cannot play thus adversely affecting profitability of iGaming companies. Respondents also said that due to responsible gaming compliance, they cannot advertise freely to increase their profit margins. Respondents also stated that since their infrastructure allows their staff to work from home, the risk associated with contagion is reduced. Furthermore, iGaming companies do not need a physical location to meet clients and carry out business as much as banks do. Respondents confirmed however, that this creates an opportunity for increased risk of cyber-attacks and fraud.

*Profitability and amendments to the business model:*

This research confirms that COVID-19 is a risk event threatening the profitability of both banks and iGaming companies. Respondents from both industries mentioned that this threat to profitability is brought about by the increase in severity and probability of risks which necessitate amendments to the business model. Banks focusing on lending need to shift their business to other areas since with increased unemployment, lower disposable income, and businesses feeling the pinch, there is a sharp rise in credit risk meaning that their legacy business could be rendered unprofitable and unviable. iGaming companies focusing on sports betting need to follow suite subsequent to the cancellation of all major sporting events on which players can bet on. iGaming respondents confirmed that their sportsbook revenue stream had practically ceased.

Both industries need to change the channel in which they operate in; often requiring investment on infrastructure to support the rapid onset of COVID-19. Banks have reported that COVID-19 serves as a catalyst to implementing changes such as remote-working and an increase in efforts related to promotion of online and mobile channels to move away from the physical banking in branches. On the other hand, iGaming companies have reported that they did not require major changes to the way they interact with their clients given that remote interaction and certain investment in their infrastructure were already in place.

*Adapting to COVID-19:*

Respondents from both industries classified COVID-19 as a fast-developing emerging risk; due to the uncertainty in its impact and severity, and the difficulty in quantifying this risk. Respondents said that the significant effects of this phenomenon were not predicted as these have never been experienced before. In banks, COVID-19 leads to other emerging risks which need specific management and control.

Banks who rely heavily on physical presence might notice their business being taken by Fintech who require no physical interaction. COVID-19 is accelerating the existing trends of moving away from face-to-face interaction to increasing online presence. Another emerging risk for banks is societal and economic changes which require banks to adapt their financial services offer, their lending strategy and their network set-up in a radical way.

With the rapid onset of COVID-19, some known risks which both industries face have become even more significant. Respondents mentioned the increase in cyber risk aggravated by remote working which has expanded the attack surface of the IT network, whilst also creating stress on internal controls. Another heightened risk is operational risk whereby continuity strategies need to be in place to minimise disruption from processes, systems and employees getting sick.

Furthermore, iGaming companies have also been negatively impacted by restrictions imposed by governments namely the cancellation of sport events bringing revenue streams from these events to a halt. This prompted some iGaming companies to shift their operations to e-Sports (betting on the outcome of online video games), with companies fast-tracking the development, technology and infrastructure towards Esports. Companies who have not tested the waters in the past, will find this as an emerging risk with unknown effects on the profitability and risks this new venture might bring. Finally, iGaming companies who are reluctant to implement a change in their operations would lose out to their competitors.

## **5. Conclusion**

One of the aims of this research was to analyse how COVID-19 affects two prominent industries in Malta, banking and iGaming. Some risks arising from this pandemic are unique being industry-specific risks, however, there are common financial and operational risks such as the effect on staff, the effects of lockdowns, unemployment, cyber risk and fraud risk. One can also observe the contagion of not only the disease itself, but also its effects on the economy in one part of the world, being felt in another part. This new reality brought about changes in the way business is carried out for both banks and iGaming companies. These changes can be classified as emerging risks, since both industries were not prepared to handle such a pandemic and its devastating effects in such a short period. In fact, this research concludes that banks and iGaming companies who have effective business continuity measures and sufficient agility, managed to control the effects of the pandemic to allow them to remain in business.

Furthermore, one can conclude that COVID-19 is an emerging risk necessitating adaptation to the business model as otherwise it could lead to disruptions and decline in profitability or even losses. The threat to profitability is what led banks to invest more in their virtual presence and iGaming companies to have an infrastructure for Esports. It is important to note that had no measures been taken to adapt and mitigate



the risks associated with COVID-19, banks and iGaming companies in Malta would have experienced a much worse scenario, especially keeping in mind the long duration of such pandemic in Malta and around the world.

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