

Strategic customer management for business banking portfolios

A practical decisioning approach
to improve portfolio management



Strategic customer management for business banking portfolios

Table of Contents

- Introduction 1
- Executive summary 1
- What are business banking clients?..... 2
- Manual versus automated customer management 5
- Customer management best-practice architecture..... 8
- Strategic business banking customer management — key components..... 10
- Single customer view 16
- Customer management models 16
- Segmentation..... 16
- Credit risk strategies..... 17
- Processes 18
- MI and reporting 18
- Strategy levers and drivers..... 19
- Limit management (increases and decreases)..... 19
- Automated renewal of facilities 20
- Risk-based pricing 21
- Early warning and collections 21
- Visualizing the data..... 22
- Case studies 23
- Conclusion 24
- About Experian’s Global Consulting Practice 24
- About the authors..... 25

Strategic customer management for business banking portfolios

Introduction

Customer management (or account management, as is often the case) for consumer lending portfolios has been a defining feature of financial institutions for many years. However, in managing business banking portfolios, this feature has been adopted in a less uniform manner, going from some of the most sophisticated and leading-edge practices within the financial institution industry as a whole to very rudimentary practices with offline scores created but utilized infrequently.

This white paper explores business banking customer management and the benefits that can be realized from introducing a strategic approach. It will look at the features of a leading-edge approach to business banking customer management and provide practical insights on key areas.

Executive summary

This white paper is targeted toward those wishing to improve their capability for business banking customer/account management by making greater use of decision tools.

It examines each of the areas within the decision tool environments, highlights how these help and provides practical examples relative to business banking decision-making processes. The document covers:

- The nature and type of the business banking segment that is suited to automated decision making
- What an automated business banking customer management decision-making environment might look like
- The many data sources that add value in business banking decision making
- Understanding the use of models, segmentation and strategy setting for business banking
- The benefits that early adopters already have achieved

Using automated tools for customer management has enabled retail lenders to materially reduce the cost of lending and improve service to customers while maintaining portfolio quality within the lenders' risk appetite. Typical results include:

- Time to decision reduced by 20 percent to 30 percent
- Cost efficiencies of 5 percent to 10 percent
- Improved bad debt rates of between 1 percent and 5 percent

The tools described are used extensively in the consumer lending arena but can be just as effective within the business banking environment. In terms of automation, most business banking lenders are not as advanced as retail consumer lenders.

The document focuses on those business banking clients that are suited to automated decision making. However, early adopters also have benefited from the insight, very often proactive, that the same tools can provide for judgmental decision making.

Strategic customer management for business banking portfolios

What are business banking clients?

Business banking clients — small and medium-sized businesses (or small and medium-sized enterprises, as they are referred to in the United Kingdom) — are classified differently by each segment of the financial institution industry. Within an individual institution alone, there are many differing approaches:

- Outbound marketing/business development will segment based upon sales size of the client, up to \$10 million in annual sales
- Underwriting and portfolio management will segment based upon total exposure and product terms and conditions, such as clients with exposure up to \$500,000 with noncomplex credit facilities (nonborrowing base supported lines of credit, for example)

Elsewhere, the categorization changes again:

- The U.S. Small Business Administration (SBA) defines a small-business concern as one that is independently owned and operated, is organized for profit and is not dominant in its field. Depending on the industry, size standard eligibility is based on the average number of employees for the preceding 12 months or on sales volume averaged over a three-year period. Examples of SBA general size standards include the following:
 - **Manufacturing:** Maximum number of employees may range from 500 to 1,500, depending on the type of product manufactured
 - **Wholesaling:** Maximum number of employees may range from 100 to 500, depending on the particular product being provided
 - **Services:** Annual receipts may not exceed \$2.5 million to \$21.5 million, depending on the particular service being provided
 - **Retailing:** Annual receipts may not exceed \$5.0 million to \$21.0 million, depending on the particular product being provided
 - **General and heavy construction:** General construction annual receipts may not exceed \$13.5 million to \$17 million, depending on the type of construction
 - **Special trade construction:** Annual receipts may not exceed \$7 million
 - **Agriculture:** Annual receipts may not exceed \$0.5 million to \$9.0 million, depending on the agricultural product
- The European Union's current definition categorizes companies with fewer than 10 employees as "micro," those with fewer than 50 employees as "small" and those with fewer than 250 as "medium"
- Canada defines a small business as one that has fewer than 100 employees (if the business is a goods-producing business) or fewer than 50 employees (if the business is a service-based business) and a medium-sized business as one with fewer than 500 employees
- In New Zealand, a small business has to be 19 people or fewer

The definition varies globally; this is also the case across organizations. However, most are based on a definition of annual sales (usually less than \$10 million) and existing borrowings (usually less than \$1 million).

Strategic customer management for business banking portfolios

In most economies, smaller enterprises are much greater in number. Figure 1 highlights how business banking clients in the United States comprise the majority of businesses in terms of numbers but not employment or sales.

Figure 1: Business banking in the United States

Enterprise Employment size	Number of firms	Number of establishments	Employment	Annual payroll (\$1,000)
Total	5,767,306	7,433,465	114,509,626	4,855,545,239
0–4	3,588,708	3,565,433	5,966,190	219,913,105
5–9	1,001,313	1,015,178	6,580,830	212,718,822
10–19	610,777	646,145	8,191,289	278,321,099
Fewer than 20	5,170,798	5,226,756	20,738,309	710,953,026
20–99	495,673	672,753	19,389,940	719,054,001
100–499	83,326	353,510	16,153,254	654,811,946
Fewer than 500	5,749,797	6,253,019	56,281,503	2,084,818,973
500 or more	17,509	1,180,446	58,228,123	2,770,726,266

Source: *Statistics of U.S. Businesses 2009 Annual Data* — US Census Bureau
(Website: <http://www.census.gov/econ/susb/>)

The information above is more or less replicated across the globe, though in emerging markets this is less pronounced. In India, the micro and small enterprises (MSEs) sector plays a pivotal role in the country's overall industrial economy. It is estimated that in terms of value, the sector accounts for about 39 percent of the manufacturing output and around 33 percent of the country's total export.

Across small businesses themselves, there are typically three main classifications of legal status:

- Proprietorships
- Partnerships
- Corporations

From a U.S. perspective, the graph below highlights the typical split among these by type of business.

Figure 2: Total number of businesses by type

Total	Nonfarm proprietorships	Partnerships	Corporations
Number of tax returns	22,614,000	3,146,000	5,847,000
Business receipts (billions)	\$1,317	\$4,963	\$27,266

Source: *U.S. Census Bureau — 2008 Tax Year*

Strategic customer management for business banking portfolios

As can be seen from all the numbers above, the business banking sector holds the largest number of businesses. As you move up the turnover bands, the number of businesses within these decreases significantly, which reduces the ability to create robust statistical models and high degrees of automation.

In addition, as larger businesses tend to involve complex relationships — usually part of corporate or commercial group structures — the ability for automation is further hampered. This, combined with the fact that large businesses tend to have much higher exposure levels, easily justifies a more “expert-” based approach. While such business typically will have receipts much greater than \$1 million, the above chart adequately represents the disparity in numbers as the annual sales size increases.

Figure 3: Prescriptive treatments versus expert tools

Number of organizations

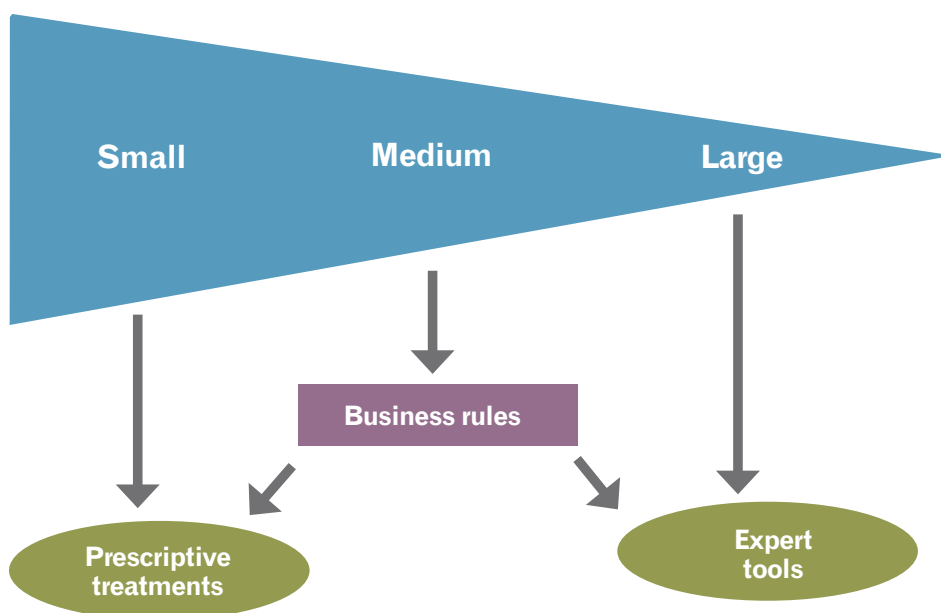


Figure 3 above clearly illustrates where prescriptive treatments can best be assigned within the business banking segment. It is for this reason that we are concentrating on small businesses in this white paper, as they lend themselves more to automation and the benefits that can be realized from a strategic approach to customer management.

Strategic customer management for business banking portfolios

Manual versus automated customer management

Customer management is the systematic use of data, analytics and software to create customer insight and intimacy to undertake actions and generate better returns on business banking portfolios, particularly from lending activities. This includes, though is not limited to:

- Scoring
- Forecasting of bad debt and provisioning levels
- Exposure management
- Automated renewal of facilities
- Risk-based pricing
- Pay/No-pay decisions
- Early warning
- Early collections
- Cross-sell and up-sell

Many institutions with business banking customer bases find it impossible to cost-effectively address the needs of small businesses without a strategic set of tools and processes to help them. With effective customer management tools, a significant proportion of the above areas can be automated to reduce human intervention — and therefore costs — and simultaneously improve customer service. The use of automation also enables staff to be targeted to the most appropriate tasks, such as revenue-generating activities (knowing what the limitations on lending are up front and thus reducing research for relationship managers) and problem loan management.

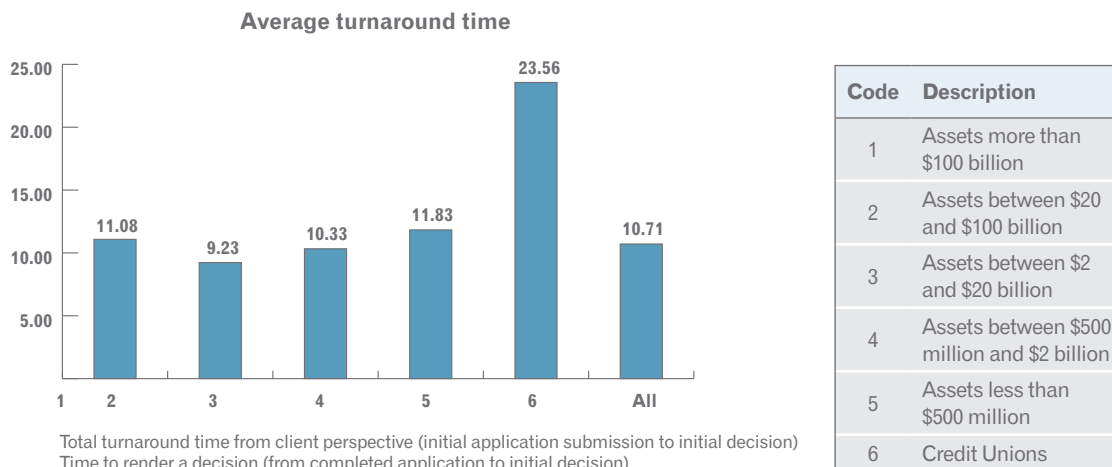
Where manual treatments are pursued, these lead to many disadvantages, which primarily consist of:

- **Inconsistency of decisions** — As they all will be subjective, these decisions will differ among relationship managers. This in itself could lead to significant compliance team actions to check that manual policies are being followed and manual review of any potential regulatory violations.
- **Time-consuming and expensive processes** — Rolling out a change in credit policy involves large overhead in training as well as the need to ensure that staff follow it. Decisions take longer, and this impacts customer service and the perception of an organization.
- **Lack of control over credit policy** — With manual processes, the credit manager has limited control over what is actually lent, except within the guidelines issued.
- **Expensive if not unprofitable servicing of lower-value customers** — Small-value customers with lower borrowing requirements do not require a sophisticated relationship management structure with highly trained staff. Quick and effective decisions need to be made at the least cost to an organization.
- **Lack of auditable processes to show how decisions are made and whether credit policy is being followed** — This must be done without the need for expensive and manually intensive processes to record what was done, when and by whom.

Strategic customer management for business banking portfolios

If we look at where automation has been effectively implemented, the benefits can be identified easily. The benefits are highlighted in Figure 4.

Figure 4: Lending decision-making time — The full time taken to make a lending decision varies materially between financial institutions.



Questions: How long does the process take from the commencement of the application process (record of proposal started in system) to the submission of the application to the credit decisioning unit/system (all data required received)? How long does it then take from the receipt of the completed application to the credit evaluation result being communicated to the customer?

Source: Experian Bank2Business 2010 small-business study

The longer it takes to lend, the following actions are typically observed:

- For the organization:
 - Good customers will tend to migrate to more efficient organizations, so the poorer-performing organizations are left with the more risky customers.
 - Business is lost (through slow reaction time) to rivals. Costs are higher. Low automation leads to more time taken, more people reviewing a loan request and more hurdles to overcome. Thus, profitability is hit or rates become uncompetitive.
 - Reduced ability to be competitive on price because of higher costs.
 - Slow ability to adapt to changes in the marketplace, e.g., economic or competitive factors.
- For the customer, low-level automation leads to high dissatisfaction with the process, complaints and switching institutions because of:
 - Significant waiting time for decisions on credit requests, which potentially affects their investment plans

Strategic customer management for business banking portfolios

- Having to spend more time on banking issues than on making their business work
- Providing information that they have supplied before and that they expect their finance provider to know
- Staff members end up:
 - Spending valuable time on non-value-adding processes
 - Having less time to explore the customer's needs for other products and services
 - Leaving to work for another, more efficient organization

Where automation has been successfully implemented, organizations have seen significant benefits in terms of:

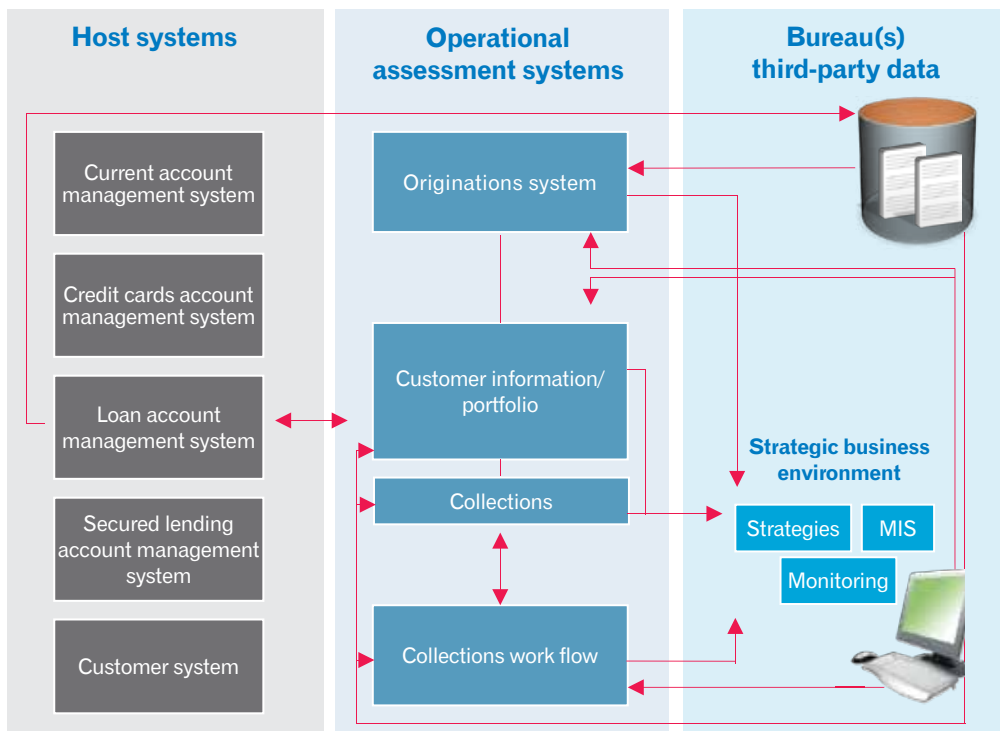
- The customers
 - Faster response to their requests, i.e., cutting the time to decision from days to minutes. Speed of lending decisions is of primary importance to small businesses and tends to override any price sensitivity.
 - Less time wasted resubmitting information that already has been supplied and that the organization should know, i.e., length of time the business has been in operation.
 - Better intimacy as their lender uses the information it has to proactively manage the customer, i.e., calling when there is a change in payment patterns.
- The organization
 - Lower cost of operation from quicker decision making, optimized processes and reacting quickly to a customer's change in circumstances. It is not uncommon to see 5 percent to 10 percent operational cost savings.
 - Consistent treatment of customers and the same decision regardless of who provides it.
 - Credit policy applied consistently and with credit risk managers having full control over it.
 - Enterprise-wide customer risk knowledge.
 - Higher profitability from better pricing decisions.
 - Lower cost base from effective use of staff resources.
 - Lower bad debt rates, typically between 1 percent and 5 percent.
 - Higher-quality customers.
- The staff
 - Less time spent collecting information that is already available. Some organizations key the same data five times as part of a lending decision for a strong existing customer. Automation removes this.
 - Faster and more consistent processes.
 - Less paperwork to complete.
 - More knowledge of their customers' financial behavior.
 - Risk data at their fingertips.

Strategic customer management for business banking portfolios

Customer management best-practice architecture

The diagram below outlines Experian's best-practice architecture, highlighting the use of data, decisioning and management information (MI) across the originations, customer management and collections arenas, with control maintained by the business.

Figure 5: Best practice architecture



Taking each element in turn:

- **In-house data** — Core banking systems will hold all key data on how accounts are currently being operated, covering transactions, limits, missed payments, etc. To enable a customer-level view, the customer management system will maintain the linkage between individual accounts and customers.
- **Credit bureaus** — Credit bureaus will hold information on how a customer is performing with credit agreements both within an organization and, more important, outside of that organization. This information provides a holistic view of the customer — both the business and the people behind it. Using full personal and business information can improve decisioning accuracy by up to 49 percent. Achieving Gini (a statistical measure of scorecard discriminatory power) levels of 85 percent is not uncommon in these instances. The data held can be used to:
 - Verify and authenticate the applicant's identity (fraud, Know Your Customer).
 - Check the entity's payment performance history with other lenders and suppliers (consumer and business, with permissible purpose for the data request).
 - Verify accuracy of consumer financial reporting using open trades on the credit bureau.

Strategic customer management for business banking portfolios

- For originations and customer opening, checking against internal customer performance data sources should be carried out as close to real time as possible to identify previously rejected applications (origination system), existing bad accounts (core accounting system) or known high-risk profiles (origination system or prescreen). It is equally important to acknowledge established good-risk customers where a quick decision can be reached. For many financial institutions, lending to existing customers accounts for nearly 80 percent of their total lending. The information that the financial institutions have via the customer's account transactions and behavior provides powerful insight into the financial health of the customer's business. This contrasts sharply with a new customer (a start-up or a switcher from another financial institution), where all information has to be requested.

Using existing information ensures that the customer has a good experience and that known good customer performance is taken into account. Where the risk dictates, credit bureau checks also should be made in real time and carried out for all the addresses supplied, partners (e.g., joint applicants) and guarantors that carry the liability of the debt.

Underpinning this whole process should be a flexible decision engine enabling the customer to be segmented, the request to be scored, policy rules to be applied and terms to be set, along with any further process to be enacted and data to be collated.

- The customer management system controls all aspects of ongoing credit risk management. As in the origination process, consumer and business credit bureau data should be used in conjunction with internal customer performance data (e.g., current account data and customer contact history, if available).

A suite of customer-level behavioral scores should summarize all available data into key indicators of future behavior and be applied to key segments such as strength of relationship, time delinquent and product type. The customer management system should be able to run monthly and daily. From a monthly perspective, behavioral scores can be set along with lending limits and shadow limits.

With daily processing, this will be more "event based" and will be driven by either changes in internal data (missed payment, increased utilization, excesses and customer contact) or bureau data, such as court judgments noted, missed payments elsewhere and legal notices (e.g., bankruptcy). Where event-based processing occurs, this could lead, for example, to a downgrade in preapproved limits through to triggering a customer to be assessed for collections activity through a strategic collections scoring tool. "Real-time" processing also will be required in this area to make decisions driven by interactions with the customer, such as authorizations, customer contact and real-time collections (following a customer flagging an event), etc.

- With the strategic collections tool, all available data is used to assess triggered customers. This will be internal behavioral data covering both the customer and his or her associated accounts, bureau data and events. In addition, it also will include current (where the customer is undergoing collections activity) and previous (historical actions and results from the collections system) information to assess whether contact should be made and the harshness thereof. This could be from predelinquency through collections and recoveries. Within this whole process, data from all areas is used to assess the customer and what actions should be taken.

Strategic customer management for business banking portfolios

- In the originations, customer management and collections processes, segmentation, scoring, setting of limits/actions and strategies should utilize a highly flexible, enterprise-wide decision management tool with test/control facilities that are controlled by the business.

This area should have access to all relevant data from all points in the process along with the appropriate outcome data to enable:

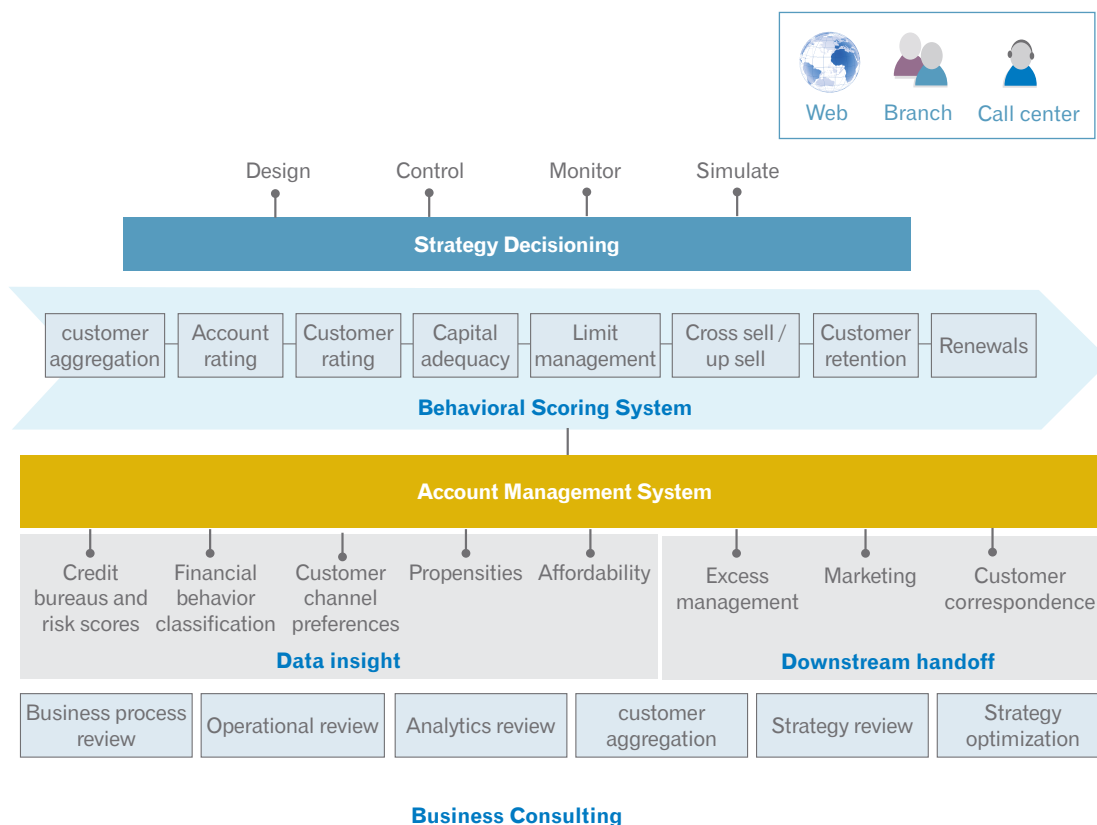
- All MI to be produced
- The value of both internal customer data and external credit bureau data to be maximized
- The ability to “simulate” change in order to make the most effective decisions
- Strategy changes to be robustly tested
- Enterprise-wide decisioning to be applied

As can be seen, the customer management system sits at the heart of this whole infrastructure. As 80 percent to 90 percent of all interactions within the business banking segment in the financial institution industry are with existing customers, the importance of a strategic customer management platform sitting at the center of everything, helping to drive all aspects of interaction with a customer, cannot be understated.

Strategic business banking customer management — key components

The building blocks for a world-class customer management approach are shown in the diagram below:

Figure 6: Building blocks for strategic business banking customer management



Strategic customer management for business banking portfolios

Let's look at each of these areas in more detail.

Data

For any customer management system, data is inevitably the key. With a weak data set, even the most sophisticated customer management system will be suboptimal. Conversely, a strong data set and poor customer management approach will be restricting but probably will be superior to the prior scenario. Many institutions hold a wealth of data that provides insight into their business customers' financial health even without formal balance sheets and profit and loss accounts. Financial institutions in particular have a unique window into the operation of their customers through a relationship's deposit accounts, which provides an indication of cash flow health and profitability. The key elements of data that make up leading-edge systems are the right blend of internal and external data.

Internal data

Financial institutions hold a staggering wealth of information on the business itself and potentially on the relationship tied to it.

Business data

Deposit account relationship

Where the organization holds the primary relationship with a business, it will command access to the main demand deposit account (DDA). From the DDA, we can define how a business is actually performing through both deposit and withdrawal activity on the account, with the difference providing an indication of surplus or deficit in cash flow. Looking at this over key periods — three months, six months and 12 months — we can ascertain any patterns, whether the business is growing or contracting, and whether withdrawal activity is exceeding deposit activity over the periods. In addition to the account behavior, the DDA will highlight any issues around poor behavior, such as over limit, missed payments and continuous excesses, etc. All this information taken together provides the strongest data on the performance of the business and its long-term prospects. In essence, DDA information is one of the most important elements to consider. Once you have this, an organization's capability to align its risk to that of the business is greatly enhanced.

As well as the above, the DDA also may hold short-term (though often not so short-term) borrowing in the form of an overdraft limit, which provides both a working capital capability to meet cash flow needs and a short-term borrowing requirement. Within this, a picture of exposure when tied in to other facilities is provided, as well as performance in managing this.

The use of DDA and cash flow data

Analyzing the current account transaction data and incorporating it with a product-based performance indicator to create a customer risk grade enables significant enhancement of granularity and discrimination to small-business credit risk tools for new lending and customer management events.

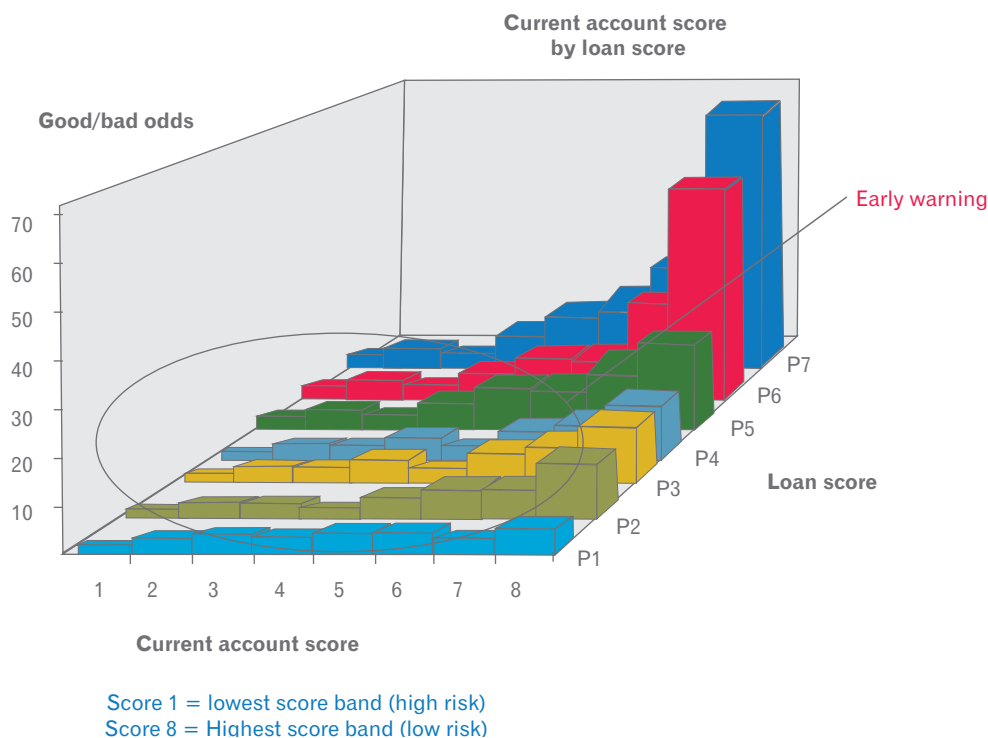
Taking into consideration the high number of insolvencies, incorporating cash flow data to assess whether short-term financial commitments can be met by the business is paramount. Cash flow often is described as the lifeblood of a business, so negative cash flow without recovery when expected can prompt serious questions about the viability of a business and can lead to its ultimate demise.

Strategic customer management for business banking portfolios

Changes in the activity on the DDA are frequently an early indication that a business is experiencing cash flow pressures. This could be a hardening creditor position (trade payables), or a business could have utilized working capital for an asset that would have been more suited to a loan. These early warning signals can be used to support early intervention for judgmental decisions.

Figure 7 illustrates the added strength of cash flow data to loans. The use of cash flow data is extremely powerful in the development of behavioral scoring models that have varying objectives (e.g., renewals, limit management, pricing and collections). For example, the use of cash flow data in early warning systems enables robust treatment strategies to be developed for segments that are 30 and 60 days past due. Contacting and treating the customer early in the collections process enables lenders to restructure the debt if appropriate and enables the small business to continue trading and otherwise reduce costs to the financial institution in terms of collection and actual loss.

Figure 7: Current account score by loan score



Loans

Loans provide a good picture of existing facilities and actual borrowing. The loan data will only provide a snapshot of what borrowing a customer has. However, most important, it will show payment behavior highlighting missed payments as well exposure to the business. Of particular importance are how many facilities the business has, how recently the exposure has been taken on and the pattern thereof.

Strategic customer management for business banking portfolios

Secured lending and mortgages

As with loans, secured lending will provide a snapshot of the borrowing and collateral in place and associated performance. However, if the collateral system is robust enough (this is most often not the case), then this will provide details of collateral, including valuations, loan to value and any other data that would be pertinent for loss mitigation. This gives the lender an exit strategy that reduces loss in the event of default or business failure.

One key principle with all data assets is their accuracy and thus relevance. Good-quality collateral data will add a great deal to risk assessment; poor-quality data (e.g., unreliable valuations and thus exposure to value) will increase the risk potential.

Business credit cards

Business credit cards typically will act as short-term facilities for paying incidental expenses via a revolving credit facility. Many businesses take out business credit cards initially as a means of payment convenience and in times of stress can turn to the limit to supplement their cash flow.

Where a business uses a business credit card, trends can be ascertained as to worsening/improving balances and amount paid off each month; reliance on short-term borrowing and problems with the business also can be highlighted. As with loans and deposit relationships, repayment behavior can be utilized. This helps add to the overall picture of the business.

Personal data

As well as the business transacting with an organization, the principals of the business also may use the financial institution for their personal banking services.

The data available on the individual will be much the same as with the business, and its uses will be the same. When looking at the business, typically a summarized view of the people behind the business will suffice with internal data. The following information is the most useful:

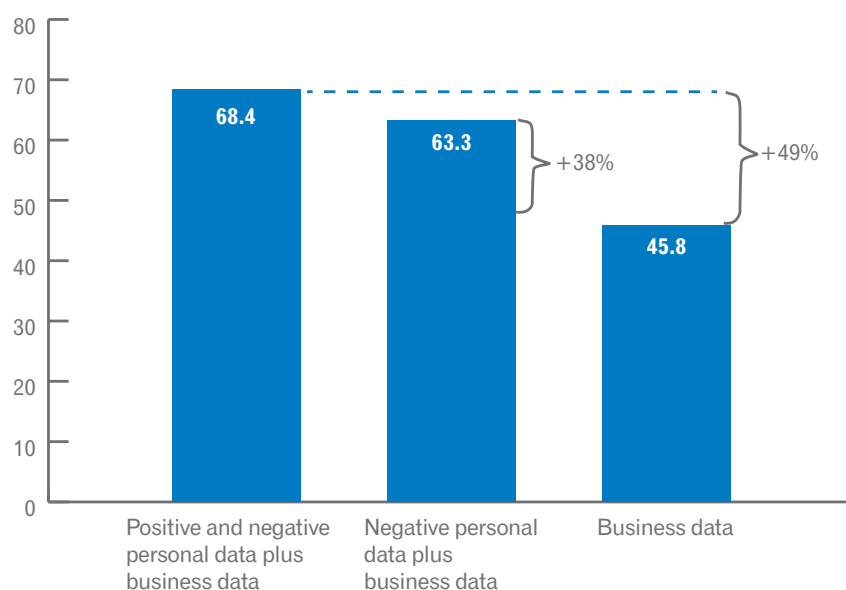
- Behavioral risk grade
- Outstanding balances
- Strength of relationship marker
- Details on performance (negative and positive)
- Trends
- Personal assets and security

Personal data on the principals of a business is predictive of credit risk and helps to create a more comprehensive picture of the entity's risk profile and financial history. This can be factored in when assessing the risk associated with the business. In particular, personal data adds significantly to business data for new relationships — such as start-ups — due to the lack of predictive business data. It has less impact on established, primary relationships because of the abundance of predictive business data.

Strategic customer management for business banking portfolios

The graph overleaf illustrates the predictive power of adding consumer credit data to small-business lending bureau models. For businesses that are new-to-financial institution situations or where there is a relatively weak relationship (in information terms), as is the case for most asset finance lenders, then the power of adding personal data into the scoring model is significant. This is especially true for small businesses where the financial behavior of the principals is inextricably linked to the health of the business. This is not necessarily the case where the entity is a large business.

Figure 8: Scorecard predictiveness (Gini coefficient)



Consumer data on proprietor(s) adds significantly to predictive power.

Source: Experian Decision Analytics. The Gini coefficient measures the ability of a scorecard to discriminate between good and bad customers (a range of 0 percent to 100 percent). A large Gini indicates strong discrimination.

External data

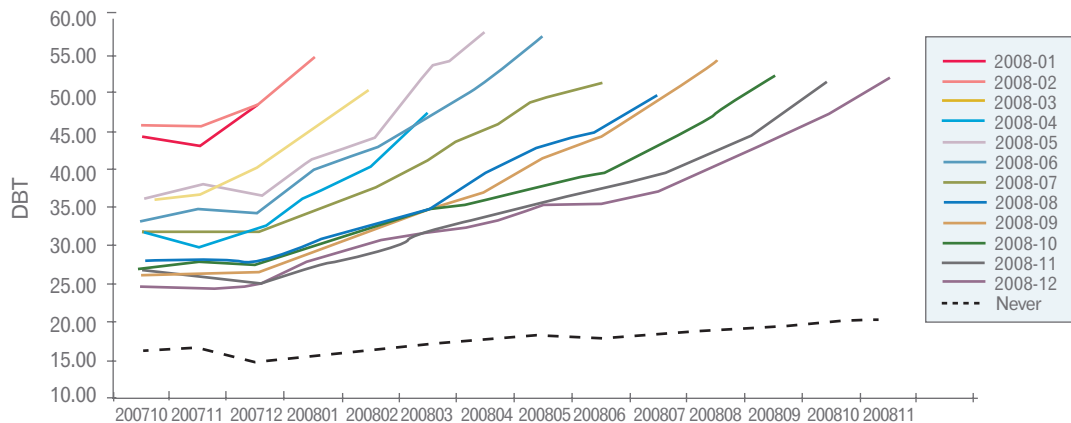
From a business data perspective, there is currently a large amount of data available. Public information is a valuable source of data that can be included in the decision process.

- Entity data can include legal entity structure in addition to principals, partners, etc. Additional data available also may provide business start dates and any changes in the business structure or management.
- Derogatory information can provide data on judgments, liens and bankruptcies to determine any potential risk.
- Business and principal payment performance can give an early indication that a firm or an individual is struggling to meet its commitments.
- Principal information may tie them to other business entities.

Strategic customer management for business banking portfolios

As organizations across the world share data, greater information is available for risk assessment. This in itself will lead to more powerful data being available on businesses — particularly those larger small businesses where consumer data may not be available due to compliance purposes or where a customer has multiple banking relationships. This additional full credit data, when combined with trade-credit performance data, will lead to more powerful models being created on the business itself. In turn, this will lead to an increase in the Gini coefficients seen above.

Figure 9: Average DBT of each cohort of 2008 insolvencies with firms that did not go insolvent (black dashed line)



Bureau data services

- **Batch bureau** — provision of a snapshot of the customer at a particular point in the cycle (weekly, monthly) to aid in the management of the customer.
- **Bureau events** — provision of daily information about any key changes in the customer so that appropriate actions can be carried out. This could be around removal of preapproved limits through to delinquency and collections activity. This typically is part of an overnight process.

From the bureau, we can check:

- The entity's payment performance history with other lenders and suppliers (consumer and business, if permitted) but also defaults, court judgments and insolvency.
- Inconsistencies in personal details supplied by matching to recent credit applications at the credit bureau.
- Credit bureau score summarizing all of the above data.
- Credit history and performance of the principals of the business.
- Trade-credit performance. Information on how customers pay their suppliers days beyond terms is very indicative of the cash flow health of a business. Evidence shows that customers with rapidly deteriorating payment trends are more likely to fail than recover.

Strategic customer management for business banking portfolios

Single customer view

To maximize the data available and provide the best inputs into risk and marketing assessment, all organizations need a single view of their customers and the relationships across the whole of their group. This is particularly essential within financial institutions, where a customer may have relationships with multiple divisions of the financial institution as well as across multiple entities.

For example, business A may be owned by person X. Person X owns businesses B and C as well. All of these businesses use the financial institution for the majority of their banking needs, but these are serviced through different divisions, teams and branches.

This holistic view of the customer is essential under Basel II and regulatory exposure requirements but also to ensure that the appropriate risks and exposure levels are known at a group/relationship level.

It is important, however, to put this in context. For most financial institutions, the vast majority of businesses in a business banking portfolio do not belong to multiple entity groups. Indeed, more than 60 percent are often noncomplex, single-entity proprietor businesses.

Customer management models

Leading-practice lenders have created customer management models to cover a variety of elements, which typically include the following areas:

- Behavioral probability of default models predicting the riskiness of a borrower on a monthly/quarterly basis
- Loss given default models that forecast the loss that will be incurred should a customer default
- Renewals models that predict which customers' facilities can be safely renewed
- Propensity models that predict which customers are likely to purchase a certain product
- Customer value models that estimate the value of a customer to the organization both today and in the future
- Pricing models that determine what price is required to cover operational, risk, funding and regulatory capital costs with a profit margin

Combining these models allows institutions to assess not only which customers are good credit risks, but also who can be targeted for lending products and at what price. Leading-edge customer management systems will feature some or all of these models and will use the outcomes from them to drive interactions with the customer as well as elements such as provisioning. The effective use of these can lead to large benefits; for example, one institution experienced a 7 percent reduction in impairment charges.

Segmentation

A significant element of any customer management framework is segmentation, which is the selection of specific subsets of the customer base for particular sets of treatment. This is the fundamental building block in enabling different decisions to be made for sets of customers who demonstrate similar behaviors or characteristics.

Strategic customer management for business banking portfolios

Sophisticated segmentation enables more appropriate customer-centric treatments to be applied rather than coarse or one-size-fits-all approaches that are often followed when dealing with customers.

Within strategic customer management systems, the capability to segment customers can be limitless. Thus, the sophistication applied can become truly focused. The important element is having the right attributes to inform that process. Some of the key items that go into business banking segmentation around the globe are:

- Age of business
- Months of data available
- Strength of customer relationship
- Size (annual sales)
- Recent delinquency
- Industry sector
 - Agriculture
 - Professionals (e.g., doctors, dentists)
 - Real estate (e.g., landlords)
- Highly seasonal sales

A key factor in risk segmentation is the strength of the existing relationship. Where a primary banking relationship exists, strongly predictive scorecards and prescriptive lending strategies can be designed. The degree of prescriptive decision making is much less for weak relationships.

A strong or weak relationship can be defined in a number of ways:

- A strong relationship is a primary banking relationship that exists for more than 15 months. This allows for at least an attempt at assessing whether the business is subject to seasonal trading.
- “Primary” means the main deposit account for the business (usually a DDA in the United States) has large volumes of credits and debits.

Credit risk strategies

The need to set different strategies is paramount to ensure that appropriate decisions are made for the segments identified. Having a system that allows rapid deployment of new strategies gives competitive advantage to an organization, as this allows it to quickly adapt to new circumstances arising from:

- Economic conditions
- Competitive landscape changes
- Regulatory changes

This area is covered in more detail later in this white paper in the section on strategy levers and drivers.

Strategic customer management for business banking portfolios

Processes

Many credit processes traditionally have been manual, thus time-consuming to undertake, using up valuable staff resources that would be better focused on high-risk or high-opportunity customers.

With greater automation, more processes can become systemized, leading to increased staff availability and ensuring that tasks are not missed because of pressures in dealing with other matters. A world-class customer management system will enable automation of key tasks, such as line renewals, and ensure that more straightforward tasks, like increases in facilities, are streamlined where possible to reduce time and remove obstacles. This time then can be reinvested in more customer contact and familiarity.

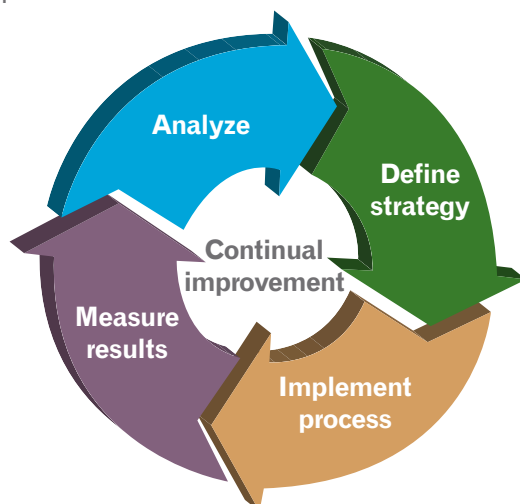
Just as important is being able to systematically flag customers who are struggling and need attention to help reduce bad debt. However, it is also important to be able to target customers who have potential for future growth.

MI and reporting

This is an area that is vital to ensure that actions and decisions are measured, monitored and amended in line with business goals and objectives. Having systematic data at account and customer levels allows a portfolio view of risk to be built and harnessed. Subsequent insights can help inform credit and business policy and strategy. For example, if medical professionals as a sector are proven to be low-risk, what changes in credit policy could be made to expand lending to that sector?

Without MI, no meaningful reporting can be carried out and no strategy improvements can be made. To establish a world-class customer management system, you need a world-class MI warehouse holding all relevant data. Thus, reports should be automated, and these in turn should highlight areas of success as well as problems and potential problems. Where problems occur, reporting tools should be available to investigate and define what is wrong.

Once problems or potential problems are defined, the data from the MI warehouse should be used to aid data-driven analytics within a safe environment where strategies can be defined/redefined using various statistical processes, results simulated and approval packs produced. The goal is to quickly highlight problems or opportunities, refine or agree to a new strategy, and then implement either across the portfolio or in a Champion/Challenger rollout. These then should be measured and reported accordingly. The key point is to enable continuous improvement to increase overall profitability and thus the portfolio's health.



Strategic customer management for business banking portfolios

Strategy levers and drivers

In this section, we will look at the principal areas of customer management and their use. The main areas are:

- Limit management (increases and decreases)
- Automated renewal of facilities
- Risk-based pricing
- Pay/No-pay decisions
- Early warning and collections
- Cross-sell and up-sell

In the following subsections, we examine a few of these areas in more detail.

Limit management (increases and decreases)

This is obviously an important component of the decision support tool and is the one that shows the most variation from organization to organization. Most customers, of course, are sensible in the amounts that they seek to borrow, and therefore these rules do not often come into play.

For existing customers (where behavioral scoring exists), it is usual for an exposure limit to be defined that represents the total amount of unsecured lending that the organization is willing to extend to the customer. These amounts are typically substantially larger than those for new customers.

Rules for determining the amount to be extended may place overdraft and loans on an equal footing for small amounts, but for larger amounts it is usual to find more generous lending for loan products.

The “annual sales” calculation takes into consideration the nature of the business. For example, a turnover of \$80,000 for a business consultant is totally different than that for a hardware store (where there is a large investment in inventory). The financial institution typically would use the most appropriate credit product to exposure (e.g., vehicle or machinery purchase could use an asset finance-style product where the residual value of the vehicle can be used to partially secure the loan).

With the wealth of data that is available within institutions, it is possible to accurately model a customer’s financial behavior. Financial institutions holding a customer’s DDA have an almost unique insight into the cash flow health of a customer and what that customer can afford to support in terms of financial commitments.

Most small businesses have straightforward financial affairs, and what passes through the current account is a fair reflection of the business’s profitability. If an enterprise is in distress, this will be reflected in reducing balances or pressure on overdraft limits.

Strategic customer management for business banking portfolios

By evaluating the transactions on the current account, financial institutions can assess what limit a business could support based on past behavior. This assessment can be supplemented by:

- **Financial information** — Full sales and profit picture
- **External bureau information** — Commitments to other lenders

The level of limit granted then can be altered to reflect:

- **Risk appetite of the institution** — A customer may be able to afford a limit of \$X,000 but is offered a more conservative, lower figure
- **Credit policy** — Certain sectors may be deemed higher-risk, so a lower limit or indeed no limit may be granted if a portfolio is being rebalanced
- **Confidence in the data**
 - If there is concern about the quality of financials provided (often the case for small businesses), then a prudent approach may be taken
 - Alternatively a more aggressive approach may be taken if it is suspected that not all revenue is being reflected either in the business's financial institution accounts or its financials (the issue of the gray market)

Having a limit precalculated is a major enabler for positive and efficient customer interactions. Relationship managers know before they meet a customer what sorts of facilities are in effect “presanctioned.” This means they can spend more time exploring the customer's other needs and building the relationship. The customer receives a rapid response to requests for funding, which is one of the key issues customers vocalize in surveys about the provision of finance.

Centralized limit calculation enables nontraditional channels such as telephone banking and the Internet to be fully effective in terms of addressing funding requests and avoids the need for a site visit, which can be costly and inefficient in terms of time.

Decreases in facilities — If a customer's finances weaken, centralized limit assessment can reveal that the customer cannot afford present commitments. In light of the relationship nature of business banking, this can trigger a discussion of the customer's circumstances and options for resolution. This may result in the financial institution reducing its exposure. Unilateral reduction or withdrawal of facilities can create adverse publicity for the institution, particularly in a recession.

Automated renewal of facilities

One of the most time-consuming activities in business lending is the renewal of facilities. As the risk of a customer can be accurately ascertained in a strong customer management system, the renewal of a customer's facilities — particularly overdrafts and revolving facilities — can be automated, and this has been the case in many organizations with strategic customer management systems. The data required for limit management can be used just as effectively in this arena.

Strategic customer management for business banking portfolios

Where the risks are low, the limits can be rolled on for another period or the relationship manager can be informed so he or she can use it as a reason to contact the customer and elicit any further required information. In some cases, limits also can be flagged for increases where appropriate (10 percent to 20 percent is not uncommon).

Where there are problems with the customer, these can be highlighted so the appropriate action can be taken and borrowing can be brought more in line with what the customer can service. The time saved by automating the credit assessment part of the renewal process is significant and can justify in itself the investment in a strategic customer management system.

Risk-based pricing

In some markets, pricing for risk (varying the interest rate, for example) has worked extremely well for loans but less so for overdrafts. This is due to customer perceptions about value for money. Traditionally, overdrafts have been quoted as x percent plus base rate, whereas loans have been quoted as a monthly repayment amount. Customers often have negotiated their x percent plus base but appear to be less concerned about rate when quoted a monthly repayment amount.

Understanding the customer's risk profile is essential to set the most appropriate price for an organization, and this has been practiced by multiple lenders for many years. To a large degree, the key metrics that go into pricing within the business banking sector are:

- Type of lending
- Customer risk grade
- Size of borrowing

Use of risk-based pricing has shown an increase of at least 5 percent in income in some organizations. With a sophisticated customer management system, these areas can be extended further and optimization techniques utilized to further refine the application of risk-based pricing and the revenue this can create.

Early warning and collections

If organizations hold the primary banking relationship, then the wealth of data at their disposal means they are in a position to highlight early warning signs of problems that may lie ahead and to act on them before it is too late. For many years, models have been created within behavioral scoring platforms to track these.

Using external bureau data helps create a 360-degree view of the customer's financial behavior. This is particularly important where the financial institution has a weaker information relationship with the customer, e.g., the customer is multibanked.

Some organizations have been able to go further than others, implementing these models into a strategic customer management system and using them to drive the activities of the relationship manager, who then can assess whether more intensive care is required. Alternatively, customers can be pushed straight to specialist support or triage teams. These teams can manage these customers more effectively through specially trained staff and help to either bring the business back to health or enable restorative action to be carried out and thus reduce bad debt.

Strategic customer management for business banking portfolios

The main aim though is to flag as quickly as possible that a customer has problems and deal with these before they become a major problem for the financial institution.

As with early warning, early collections is an important area where behavioral scoring can help to define the right actions to take with a customer. Those likely to self-cure can be left alone and nudged gently to bring accounts back in order. Those in more stress can then be escalated through the process to achieve the right outcome for all parties. The main goal here is to use segmentation to drive the most appropriate and cost-effective treatments for specific groups of customers. Used well, this can lead to significant improvements in collections performance in terms of roll rates and moneys collected.

Visualizing the data

As relationship managers often are involved in the small-businesses marketplace, they need the tools to help guide them. Customer management systems often run in the background, but relationship managers need workflow tools to help drive them to look at the right customers and be more targeted in their approach. Workflow also needs to provide them with all relevant information in one place so they can easily see a customer's profile without having to go to multiple systems and areas.

Within the process, the workflow needs to manage and aid two key areas:

- Drive relationship manager actions:
 - Highlight problem customers and ensure these are dealt with (triage and early collections)
 - Highlight customers up for renewal
 - Highlight customers with potential
 - Flag customers whose borrowing is due to be paid off so they can contact them
 - Drive contact with customers through call/touch histories
 - Flag customers with preapproved lending limits to aid new lending and cross-sell
- Provision of a single data source on all customers with track records (approximately 12 months of history):
 - Aggregated view of borrowings and deposits
 - Credit and debit turnover
 - Scores/Ratings
 - Account-level views
 - Balances and limits
 - Preapproved lending limits

With this data at their fingertips, relationship managers will be more effective and also will be able to rely on systems to highlight issues they would otherwise spend days or weeks trying to find. This will help gain a more focused team and will generate associated benefits.

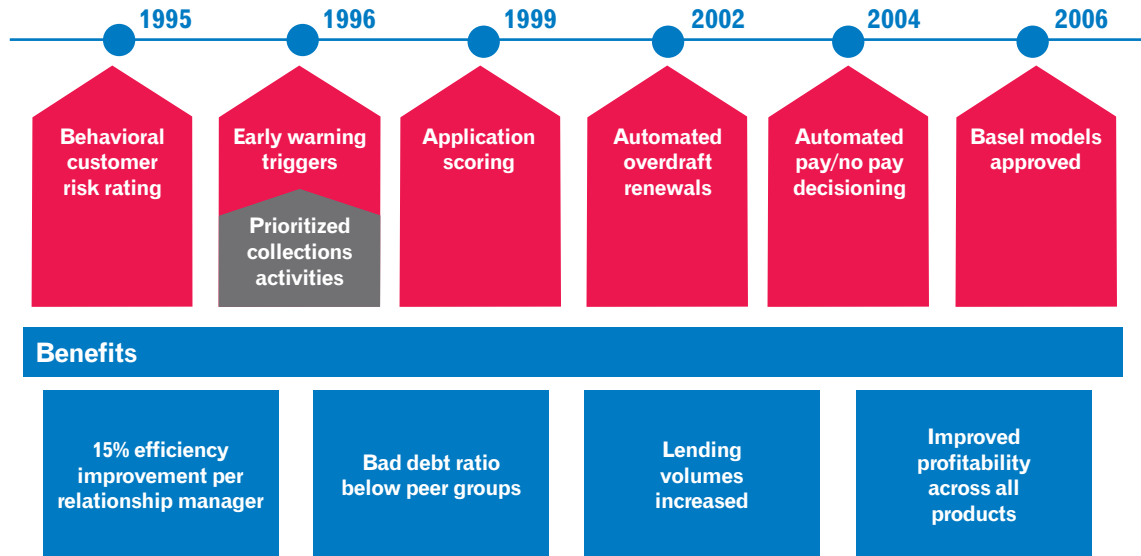
Strategic customer management for business banking portfolios

Case studies

The two case studies below highlight the benefits that two different organizations realized from moving to a strategic approach to customer management.

Case study 1

Figure 10: Gradual improvements over time



As can be seen with the lender above (a large retail bank), the organization implemented a strategic customer management system in the 1990s and has gradually improved overall elements by including additional levers and drivers and enhancing with daily processing, achieving a world-class position. The benefits realized and rewards for the organization have continually outstripped the return on investment at each stage.

Case study 2

Benefits realized by a European bank on implementing a full customer management system:

- Significant decrease in customers becoming delinquent through early warning of risk and proactive action
- Decrease of 35 percent in nonperforming lending ratio for small business since implementation
- New provision cost decreased by over 20 percent for small business segment with better risk control
- Decrease in exposure of 25 percent to risky customers with suitable management strategies and timely collections activity
- Improved collections results through targeted strategies and focused resources

Strategic customer management for business banking portfolios

Conclusion

As seen above, there are multiple benefits to adopting a strategic approach to customer management. Where automation has been successfully implemented, organizations have seen significant benefits in terms of:

- Faster responses to customer requests
- Better customer service
- Lower cost of operation from quicker decision making
- Consistent treatment of customers, i.e., the same decision regardless of who provides it
- Credit policy applied effectively and with credit risk managers having full control over its use and application
- Increased profit
- More time available for staff to devote to profit-generating activities such as cross-sell and up-sell

About Experian's Global Consulting Practice

Experian's business consultants deliver powerful insights that are used by clients to enhance credit-management strategies across their consumer and small-business portfolios and the Customer Life Cycle. Experian's Global Consulting Practice is a credentialed consultancy dedicated to creating measurable and sustainable value for organizations around the globe in financial services, banking, mortgage, automotive finance, telecommunications and utilities, microfinance, retail credit and debt collections. We specialize in analytics-based decision strategies, data-driven products and services, regulatory compliance and fraud risk management across acquisitions, customer management, collections and overall portfolio management.

Experian's business consultants provide clients with exceptional credit and fraud risk-management strategic insights, detailed enhancement opportunities, and deployment strategies through deep business subject-matter expertise and client intimacy, as well as a client engagement methodology to ensure consistency. We have deep knowledge of data, analytics and software and have demonstrated the ability to synthesize this intelligence with the deep understanding of credit-management principles and practices to solve our clients' complex business needs.

- Average of 20 years' experience per consultant
- Forty-three consultants based throughout Asia Pacific, EMEA, North America and the United Kingdom
- More than 700 engagements across the globe
- Teams with local knowledge of best practices

For more information, contact an Experian Account Executive at 1 888 414 1120 or visit www.experian.com/consultingservices.

Strategic customer management for business banking portfolios

About the authors

This content was originally published by Experian UK authors Stephen Gildert and Nick Vanstone and was adapted for regional audiences by Experian U.S. authors Joel Pruis and Didi Frohardt.

Joel Pruis is a Senior Business Consultant who is dedicated to delivering programs to his clients that increase productivity and profitability and provide financial services organizations with the tools to gain a competitive advantage in the ever-changing market. He has more than 22 years of experience in origination and portfolio management for small business and commercial credit originated via credit scoring and/or judgmental criteria, process management for small-business lending and commercial lending across all levels of exposure.

Pruis matches these techniques and processes for the business purpose of underwriting and portfolio management within the appropriate segments and balances operational efficiencies with accurate risk identification.

Frequently quoted in leading financial services publications, Pruis has quickly become one of Experian's foremost authorities on how commercial lending is catching up to the consumer industry in terms of how data is captured and used in analytics.

Didi Frohardt is a Senior Business Consultant with more than 33 years' experience in providing portfolio monitoring, credit risk, operational risk and risk process consulting services to community banks and large financial institutions. Her areas of specialization are conducting credit portfolio and financial analyses of business process for all facets of credit and loan administration.

As a consultant with Experian's Global Consulting Practice, Frohardt brings with her a 360-degree view from both the products and services and the client sides to help other institutions assess their loan portfolios and design strategies that will have a significant, profitable impact on business goals. Her attention to the smallest details, including the complexity of many loan factors, helps her to provide the very best personalized, custom service, which she oversees during the entire relationship.

Stephen Gildert has more than 20 years of experience in financial institutioning across all areas of financial services, including business development, customer management, and portfolio and credit risk management. He has had responsibility for credit decisioning systems, analytics and portfolio monitoring and has managed large-scale programs within financial institutions, automating credit decisioning and implementing regulatory change.

With the Global Consulting Practice, Gildert has led consulting engagements on small and medium sized enterprise (SME) lending automation around the world.

Nick Vanstone brings more than 10 years of experience in the credit industry, working across the Customer Life Cycle. Starting as a business analyst, Vanstone created functional designs for application processing and customer management products and services.

In his current role within the Global Consulting Practice, Vanstone works extensively in financial institutioning, providing consultancy in business processes, decisioning and data usage across originations, customer management and collections.

Experian
475 Anton Blvd.
Costa Mesa, CA 92626
1 888 414 1120
www.experian.com



© 2012 Experian Information Solutions, Inc. • All rights reserved

Experian and the Experian marks used herein are service marks or registered trademarks of Experian Information Solutions, Inc.

Other product and company names mentioned herein are the property of their respective owners.

04/12 • 2000/1142 • 6248-CS