White Paper

Is it possible to collect debt and improve the customer relationship?

Overly aggressive collections can lead to account closure and erosion of customer lifetime value. But how big of a problem is it really?

Introduction

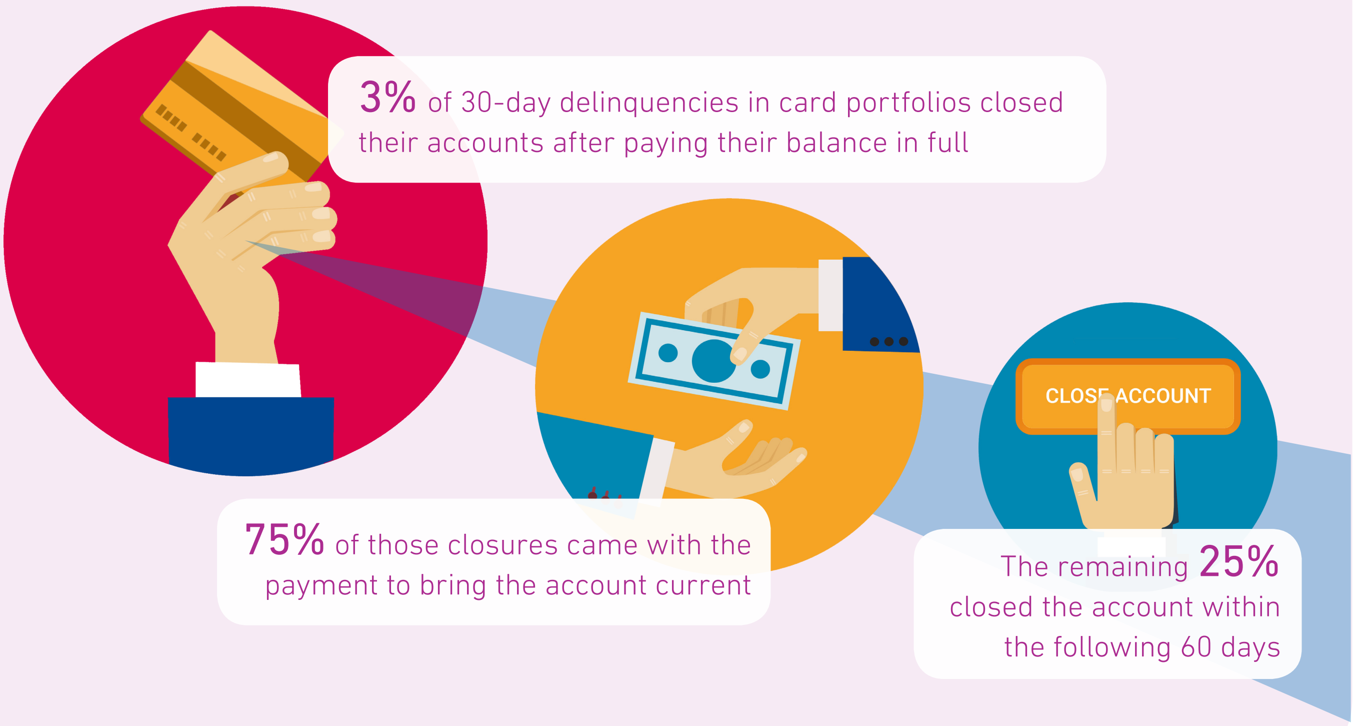
There has been significant progress in understanding customer needs and behaviors at a granular level, thanks to data intelligence. This is good news for consumers, as interactions with companies are more relevant and personalized than ever before. And businesses are better at finding and growing relationships with the consumers who have the greatest potential for customer lifetime value.

Marketing analysts are using data analytics to better predict the most attractive prospects. These tend to be consumers at a pivotal point in their financial maturity: buying their first home, building retirement savings, investing in insurance policies and more. They have a lot of choice. And with plenty of competition for their business, they are expensive to acquire in the beginning.

After acquisition, data continues to be used to inform customer decisions, including determining where to focus efforts to expand relationships and generate increased demand for products and services. But there is one area where data intelligence isn't being used to the extent it could be — collections.

The collections process is driven by the measurement of delinquency and loss, without considering the broader consumer profile. Too often, this narrow view leads to one-size-fits-all collections strategies and overly aggressive processes. But getting debt collection right is about more than money. It's about knowing the difference between a customer who has simply forgotten to make a payment and someone dealing with a financial hardship. Unless we start changing how we go about collections, keeping those customer relationships during the collections process will still be a challenge.

With this in mind, we decided to look at how the collections experience was impacting customer relationships. We performed a series of analyses to provide high-level insights to confirm the opportunity of improved segment-level treatments for improved cost efficiency and profitability. Here's what we found:



Using credit attributes initially, our analysis showed what we would expect to see: People with the lowest balances and the lowest amount past due had the highest incidence of paying off their debt and closing their accounts. The short-term impact of closing a low-balance credit card is minimal. From strictly a risk perspective, it seems like the best outcome.

We then enhanced these segment-level risk insights with our Mosaic® lifestyle segmentation systems, yielding further behavior and value prospective. Here, we found that the propensity to close was four times higher in the young, urban, affluent population than it was in others. These tend to be the customers with the greatest potential for lifetime value and the hardest for you to attract. They are also the easiest to lose.

The impact is staggering when you look at the potential of these relationships. They are the customers you are at the highest risk of losing if your collections process is overly aggressive.

Almost universally, collections departments have tended to look only at the risk profile of their clients. Even where segmentation is used, it's all too often very linear, considering only credit risk attributes. The goal is to control credit losses, so even the customers mentioned above fall into treatment strategies designed to efficiently bring the account current.

This singular focus has been standard practice for more than 20 years. By not building a wider view of the customer, the undesired result is irreversible erosion of potential customer lifetime value in the very segments that are the most difficult to acquire.

A better approach is to consider a cost/benefit insight into the account-level treatment strategy. By fully understanding both the likelihood of repayment and the likelihood of attrition if treated inappropriately, a more profit-oriented view can be built into the treatment design. And you get a more complete picture of what's driving customer experience — and subsequent profitability —by including the timing, manner and cost of the treatment in the calculation.

We've seen some organizations do this really well, but unfortunately they're the minority. Most are treating all delinquencies the same. Our analysis was not lender-specific. In other words, larger organizations that align treatment strategies to consumer-level behaviors and profitability are included in the 3 percent. If we were to pull those lenders out of the analysis, focusing only on those that haven't yet adopted these tools, we'd expect to find attrition rates significantly higher than 3 percent.

Why should we look at this now?

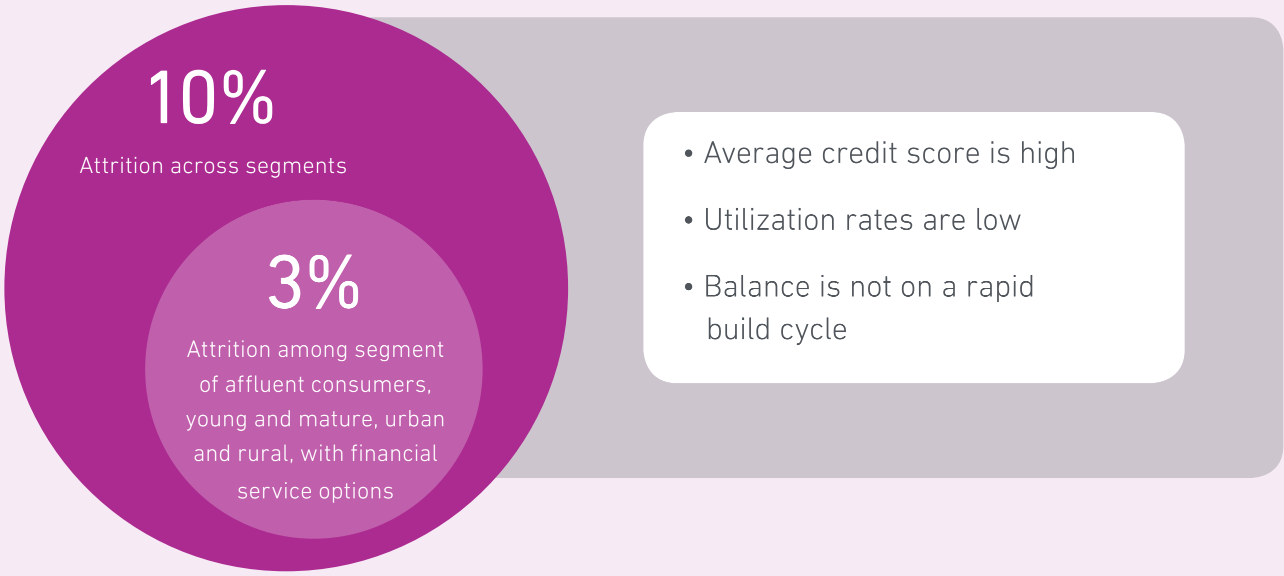
We're going through a period of change — from economic cycles and consumer preferences to regulatory pressures. Our environment is changing rapidly, and the customer experience sits at the center of most of this change. You've invested in improving the digital experience across all channels, tailoring solutions that meet both customer and business needs. But what about managing collections?

Economic indicators

Delinquencies are on the rise. In 2016, charged-off credit card dollars (U.S.) increased 15 percent. Collections has generally been left alone because delinquencies were manageable. With this trend shifting, now may be the time to review collections processes that haven't been touched in more than 20 years. Other noteworthy indicators include industry consolidation, banks holding on to debt, increased lending to subprime consumers, and more scrutiny around student loan and automotive lending. The old ways of doing things aren't working, and downturns always last longer than we expect. How well-prepared are you to adapt to the changes?

Overly aggressive collections and high-potential customers

Our analysis shows a significant revenue drain from a definably low-risk population



Consumer preferences

What *has* changed in those 20-plus years is the composition of your portfolio. You've acquired customers who are increasingly mobile, and this seismic shift to digital has changed how they interact with your business. The new standard is consumers who expect personalized, consistent, seamless experiences across channels. They also want experiences tailored for their individual situation. These expectations are being met in a variety of interactions, from online shopping to mobile banking.

These consumer preferences have pushed customer experience to the top of the priority list for chief executives across a variety of industries. This isn't necessarily a new concept, and in some places, businesses are getting it right. Take customer originations as an example. Investments are made to provide a positive customer experience in communications through digital channels, with the right offer at the right time in the early stages of those new relationships.

Unfortunately, managing and maintaining that focus through later stages of the Customer Life Cycle lags — especially when that customer experiences payment stress. There's a real disconnect here.

Analysis shows that the millennials currently in the U.S. credit consumer file represent the joint largest proportion of the total population and are probably your most valuable customers in the long run. They have balances, which suggests they could fall into the lowest scoring groups, and as such would be prioritized for that outbound call when just looking at their risk profile. The single channel approach, which is common in collections, is reaching diminishing performance with regard to the ability to reach and connect with the right kind of context. This is the biggest challenge the industry faces.

Regulatory environment

The debt collection industry is always facing regulatory uncertainty and pressure. In many places, collectors are restricted by regulations that limit the methods and frequency with which they can interact with customers. These restrictions add complexity and cost to the collections process.

The Treating Customers Fairly initiative in the United Kingdom is the most recent financial services legislation aimed at putting customers at the center of business practices. For collections, this means regulating the frequency of attempting outbound calls and the impact of unsolicited calls and harassment. It goes even further, though, requiring a certain process to confirm that customers can actually afford the payment they're committing to making.

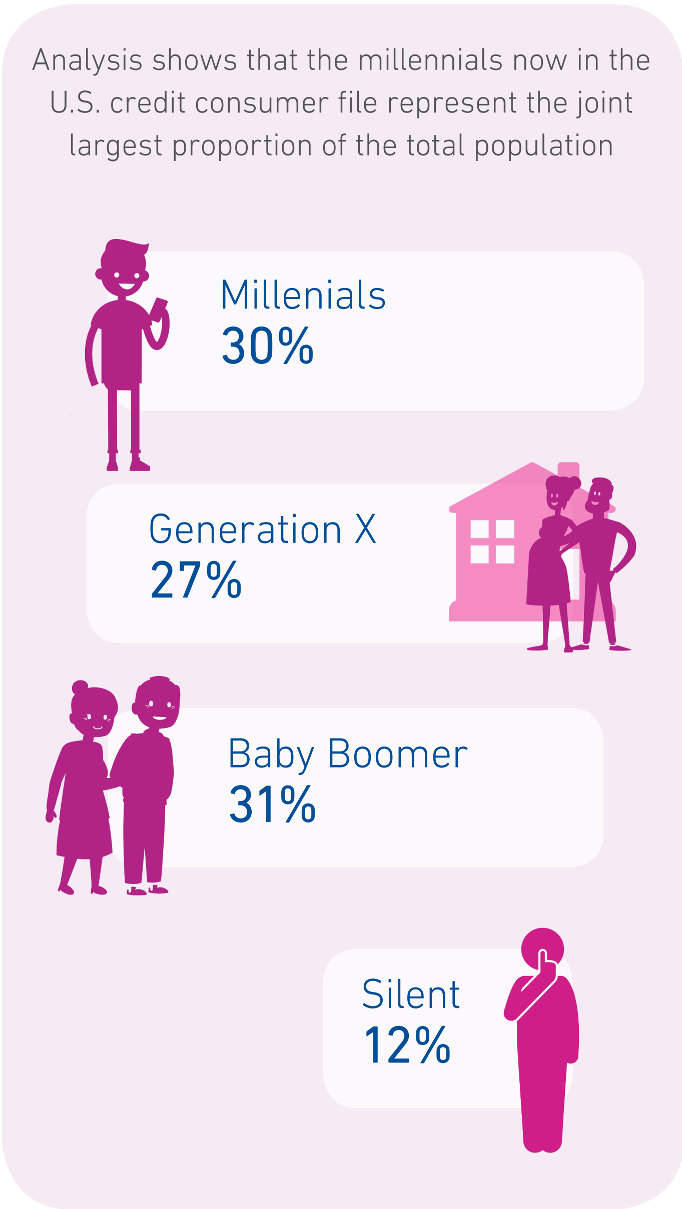
In the United States, collections professionals aren't allowed to place telephone calls to customers before 8 a.m. or after 9 p.m. And as part of the Fair Debt Collections Practices Act (FDCPA), if a customer notifies you in writing to stop contacting them, you must stop.

It's been awhile since we've seen the scrutiny that will come with two key pieces of legislation right around the corner, which will introduce two new standards — International Financial Report Standard (IFRS) 9 in Europe and Current Expected Credit Loss (CECL) in the United States. Regulation is now starting to go in an area of cost of provision, putting the focus directly on delinquent assets and, really, the retention of your most loyal, valuable customers.

IFRS 9 will question the common practice of "self-cure" — that is, recognizing delinquencies in low-risk customers and giving them extra time to cure their own balances before beginning collections activities. This has been the standard for more than 20 years, but IFRS 9 makes this practice much more expensive, as provisioning costs jump once accounts hit stage one.

And now when accounts roll from a current status to early delinquency, the cost of having that account in collections in terms of the provisions, which need to be taken against that asset in the profit and loss statement, is going to increase, some say by as much as 40 percent.

Adapting to these changes will require an increased investment in collections techniques, platforms and analytics. The customer experience is driving this change. But compliance with regulations is where the funding will come from.



Now's the time to act

Putting more focus on customer experience in the collections process isn't necessarily a new idea, but there is a potential problem with the concept. The focus can't be limited to customer experience. Anyone focusing on that alone will miss a trick. It's important to understand and solve the problem in the right place. And considering what's ahead — economic drivers, consumer preferences and increasing regulations — we believe now is the time to step back and take a fresh approach.

Start with the right key performance metrics

Collections managers typically look at their ability to and the effectiveness of stopping an account from rolling from one cycle to the next and keeping credit losses low. These are the risk attributes currently included in collections models, and they don't go far enough. Unfortunately, customer experience metrics — customer satisfaction, retention and account closure — aren't considered. But they should be. In our analysis, we saw the short-term impact on account closure and the potential long-term effect on lifetime value. What is the opportunity cost of an overly aggressive outbound collection strategy? When you look only at risk and ignore the consumer profile, the outcome is erosion of lifetime value.

Our analysis shows that young, urban, affluent consumers are four times more likely to settle their debt and close their account. If your portfolio is largely made up of this demographic, you are putting those potentially loyal customers with high lifetime value at risk with overly aggressive, one-size-fits-all collection strategies. This population is growing, and as your portfolio changes to account for this increasing segment, the impact will be much higher than 3 percent. Collections managers should consider the opportunity costs of not measuring customer experience.

Use data-driven decisioning for personalized collections treatments

Every lender has a system of records containing the repayment history of accounts entering the collections cycle. Most lenders have consumer information beyond product usage and repayment history (including demographics, valuable contact information, credit history and channel preferences). Third-party data providers can fill in the data gaps to improve the client-level insights. Every new layer of detail helps us gain a better understanding of customers. We can now customize collections to better fit each customer, minimizing the likelihood that they will feel mistreated and close the account.

Invest in technology to make the change

Current systems rely on old, clunky technology. Bringing data into a system that supports an omnichannel approach will require an investment in modern technology. Mature and widely distributed rules engines enable business-level users to build the rules to identify these segments and assign appropriate treatments. Comprehensive collections platforms give you real-time decision management capabilities to determine the optimal contact time, channel and intensity. They also offer automated, efficient collections workflow so you can carry out precise and informed actions.

Incorporate analytics to inform decision-making

Analytics should be a part of your collections strategy to inform segmentation schemes with multiple attributes such as basic demographics (like age, customer value, number of years with the institution and number of relationships within the institution).

The real opportunity for the business is customer retention. Customers who are satisfied with a convenient, interactive experience are much more likely to bring their account current and maintain it in a current status. This will enable long-term finance revenue, continue account usage and add longevity to the relationship.

The future of collections

Can your portfolio survive the attrition of your most valuable customers due to inappropriate and avoidable debt collection? It's time to embrace a different way of solving an old problem, and we don't have to look far to see what works. There is a real opportunity to take best practices around customer experience from earlier stages of the Customer Life Cycle and apply them to the collections stage. Market forces make a personalized approach highly relevant for collections. Fortunately, we have the advantage of looking at what has worked well in other areas of the Customer Life Cycle and applying those same practices to collections.

Most collections professionals agree it's the right thing to do and know there are tools available to solve the problem. But the cost can be inhibiting, especially when it's harder to get funding for operational expenses versus growing your portfolio. What we all need to realize is that there's a greater cost to doing nothing. There are companies out there that have delinquent receivables growing at exponentially higher rates than current receivables. Recognizing this should change the conversation. Now is the time to apply the power of decisioning and data intelligence to the collections process to help improve customer lifetime value.

Powering opportunities for your business and consumers

With PowerCurve®, the entire Customer Life Cycle can be managed using the same decision management platform. Through PowerCurve® Originations, you can acquire profitable customers more efficiently. PowerCurve® Customer Management gives you a complete view of existing customers. And now, PowerCurve® Collections lets you manage an end-to-end debt management process.

PowerCurve Collections enhances customer information with data from a range of sources to create a complete and accurate view of an individual. Then it brings these insights together with analytics to inform precise actions that are proven to increase recoveries and deliver a better customer experience. The best action could be a high-touch outreach effort or one that's more automated, connecting customers to a convenient, discreet self-service portal. Sometimes doing nothing is the right approach, and understanding which customers are most likely to pay on their own is critical to that decision. PowerCurve Collections has the operational capabilities to handle these actions easily. In the end, companies have a cost-effective, compliant collections process that focuses on customers and their satisfaction.

Consumers want control over how they manage accounts and settle debt. According to an Experian survey[1], **1 in every 3** people prefer to deal with debt online.

[1] Experian survey (September 2015)

www.experian.com/collections

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