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Hello

Welcome to the September 2010 edition of Euristix Insight, our newsletter which seeks to deliver unique commentary and information in the changing world of credit and portfolio management.

Recent years have underlined just how critical economic change is to our industry. This edition's lead article looks at how we need to change the way we think about the economy and how we shape our businesses around it for both good and bad.

Related to this shifting business environment, we introduce some key questions around the changing profile of customers and the market. Finally, our 'achieving best practice' article considers some of the complexities of collections segmentation and scoring - a key consideration in the control and minimisation of arrears and losses.

As ever, please contact us with any questions regarding any aspect of risk management or with feedback regarding our articles and newsletter.

Kind regards,

Chris Kemp



In this edition...

Exploiting Economic Change - With a benign and stable economy appearing to be some way away, we consider our rather turbulent relationship with economic change.

Questions Corner - With competitors disappearing and with credit availability much reduced, many lenders find themselves with both growth opportunities and unfamiliar customer profiles. How do you reconcile these two to effectively and safely manage your business?

Collections Segmentation - Segmentation tools such as scoring and decision trees are finding more and more favour in the back end collections process. We look at some of the pitfalls and approaches of collections segmentation design.

For Better, For Worse - Exploiting Economic Change



Economic change has played a significant role for most of us over the last few years. Indications are that this will continue to be the case for the foreseeable future too, and that it will be a critical factor in our business success.

With this in mind we take a look at how we think about the economy and how this could change for the better. By challenging the way we approach economic considerations in our day to day business decisions, can we take some of the pain out of this recently rocky relationship?

To read the full article, please follow the link [here...](#)

Questions Corner - Changing Customer Profiles

The downturn has led to many businesses reining in their activities or withdrawing from the market entirely. At the same time customers find their own circumstances shifting with the economy and their access to credit is much reduced. For those of us remaining this leaves us in an unfamiliar world of opportunities and unknowns. Consider the following:

- Has the onset of the Credit Crunch resulted in a change in your customers' behaviour, even if their profile seems unaltered?
- Do you fully understand the mix of customer profiles within your

portfolio and how this has shifted over time?

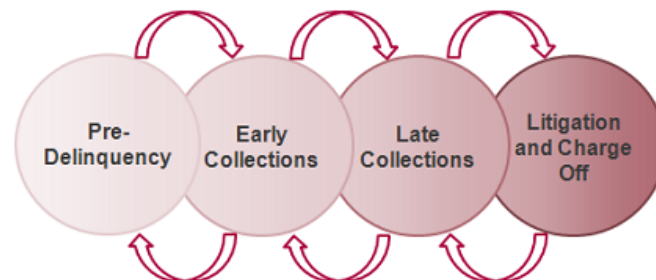
- Have market conditions driven positive or adverse selection of customers which in turn has changed their behaviour and circumstances?
- Do you believe there is now significant growth opportunity in the market which you want to be able to fully exploit? Does this growth opportunity require a move away from your traditional customer base?
- How confident are you in extrapolating existing models and assumptions into new areas? Do you believe that you can move swiftly enough to capture the opportunities but carefully enough to protect your business?

In a future edition of Euristix Insight we will look at the pitfalls and solutions to changing customer profiles in more detail. In the meantime, please direct any questions or queries to paul.matthews@euristix.com

Achieving Best Practice - Collections Segmentation

Problem – The area of collections is receiving increasing attention as businesses realise the importance of controlling arrears in today's more difficult market. The analytical tools and approaches that were honed in the front end processes are being applied to arrears and collections management in an attempt to reduce roll rates and losses. Of these tools, segmentation and scoring models are often among the most likely to be used.

However, applying such tools in collections involves additional complexities and nuances that can trip up the unwary, leading to highly sub-optimal processes. To begin with, collections is a dynamic and extended process beginning with pre-delinquency actions and ending in default, litigation and debt sale. Each of these many stages is linked so that changes in one area will have a knock on effect further down the chain. This can make model design and performance assessment a difficult task.



On top of this, collections is the one area in which we try our hardest to 'break' our models. If a business builds a score to calculate propensity to roll from early to late arrears, it will then design actions and strategies specifically intended to overturn this trend. Stronger strategies on the high risk cases are intended to drive such propensities downwards. So a successful collections score in this case would be one with vastly reduced discrimination shortly after it is implemented!

Combining these features with other issues such as data limitations, regulation, resource constraints and external influences such as the economy can make successful collections segmentation a less easy goal than one might at first assume.

Approaches – Many businesses begin by breaking the collections flow into separate stages and attempting to deal with each one independently. In some cases different teams may even be responsible for the different areas of collections and recoveries. The issue here of course is that the dependence across the collections cycle is strong.

Consider for example an early arrears segmentation which incorporates a 'self-cure' bucket in which the majority of customers are expected to return up to date with minimal intervention from the business. The self-cure rate is running at more than 80% and the organization in question is proud of this relatively sophisticated process. However, suddenly this rate drops to less than 60%. Have the models failed? Is a redevelopment required? In fact the source of the change is the introduction of a new pre-delinquency program upstream which is meaning that far fewer 'good' customers are falling into early arrears, and those that do are more likely to be those with genuine problems.

Another common approach is to over rely on scoring models. While scores are powerful tools when it comes to collating numerous pieces of information into a single metric, they can be less useful in suggesting strategies and informing customer conversations. For example, a pre-delinquency score for propensity to roll to arrears for example is most likely to highlight customers who have previously been in arrears. More helpful is to consider trigger rules which will not only flag customers getting into problems for the first time, but may suggest an appropriate remedial action.

Best of Breed – Building a comprehensive collections solution requires a heuristic approach to segmentation and scoring. It is vital to understand the interconnectedness of the various collections stages and ensure the team responsible takes a 'joined-up' view of the whole process. The criteria for measuring success need to be designed carefully, with an understanding not just that external factors such as the economy can have a huge impact but also the strategies themselves will be designed to weaken the original segmentation. Applying carefully designed champion/challenger processes can be an invaluable tool here, both to optimise the tools and strategies used and to identify the benefits they bring.

Selection of the appropriate segmentation and scoring framework needs to be governed by the use to which it will be put. Scoring is ideal for collating multiple data points and driving internal streaming, while segmentation is more suitable for capturing trigger events and informing customer conversation. The best processes will combine both tools in a way to maximize the intelligence and insight available from the data.

As businesses focus heavily on collections, this is an opportunity to put in place the frameworks and mechanisms to deliver lasting long-term value. Making the right decisions now and implementing the correct building blocks can provide an analytical platform to support your business for the future. If you have any questions or require more information on how Euristix can support your collections endeavours then please contact paul.matthews@euristix.com

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