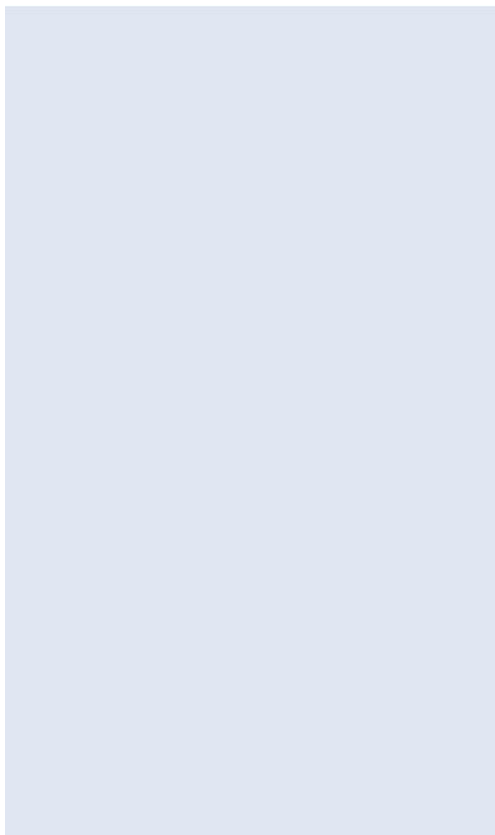


CONSUMER Predictive Analytics for
FINANCE Competitive Advantage



Fractal

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Predictive analytics and decision support solutions are enabling consumer finance institutions to increase profitability and market share by acquiring and retaining customers more efficiently while controlling credit risk.



In the financial services world, the last decade has been the decade of consumer finance. Credit exposures through credit cards, mortgages and personal loans have grown at an explosive rate across USA, Europe and Asia. This growth has not come without the associated pains of growth. Across all markets competitive pressures are beginning to have a telling impact on all aspects of the income statement.

For starters, fewer and fewer consumers are responding to the marketing efforts of banks. Response rates are at their lowest ever. Card Track reported that in the first quarter of 2004 only 0.4% Americans responded to card solicitation offers as opposed to 0.9% in the previous year. Similar statistics on usage levels, activation, attrition and defaults are not positive either. Fee incomes are down 50% over the last 10 years while default rates are up at least 1.4 times.

Banks world-over are realizing that to stay ahead of competition they must identify pockets of risks and opportunities in their current business models and optimize them to maximize profitability. Competitive advantage and profitability will be driven through a better understanding of customers, and through strategic and tactical moves around superior customer understanding and better capability to predict customer behavior.

The businesses that come ahead will be the ones that are able to do three things right

- Collect and maintain high quality customer data
- Use cutting edge predictive analytics across the organization
- Create organizational capability to implement programs around predictive analytics

Through the rest of this paper our focus will be on the application of predictive analytics and decision support solutions in the consumer finance business.

Predictive analytics allow business managers to make educated and quantifiable guesses about likely consumer behavior.



Customer Lifecycle Solutions

Predictive analytics can be applied profitably across the entire customer lifecycle in the consumer finance business. Businesses are always grappling with a wide range of issues that have a direct impact on customer profitability.

- Which customer segments are likely to respond to the next acquisition campaign?
- Which customer segments are too risky to acquire?
- What are the optimal pricing levels for different customer groups?
- What collection strategies should be adopted at different delinquency levels?
- Who are the profitable customers that are likely to leave and should be offered discounts to continue?

Through the customer lifecycle, and across the marketing and risk management functions business managers are taking decisions the impact of which is critically dependant on how consumers behave in the future.

Customer acquisition solutions like response modeling, campaign analytics and segmentation rank order prospects and identify population clusters that are most likely to respond product campaigns.



Customer Acquisition

Customer solicitation activity is at an all time high. The average number of offers a customer receives has been increasing every year while the response rates have been dropping. Falling response rates imply that marketing budgets must only be spent on customers that are most likely to respond to product offers. Further, as the product variations are increasing and products are getting more complicated, effective marketing requires targeting the right customer with the right product offering.

Customer acquisition solutions like response modeling, campaign analytics and segmentation rank order prospects and identify population clusters that are most likely to respond product campaigns. Through the use of predictive models, test and learn frameworks, and tracking mechanisms businesses can support a multitude of tailored offers that not only enhance market share but also successfully reduce acquisition costs.

Banks that use response modeling solutions have experienced increase in response rates by as much as 30 - 50%. The power of analytical modeling has put them distinctly ahead of the market.

Retail credit scoring models are the most accurate tools available to measure the risk embedded in existing and prospective customers.



Credit Origination

The need for rapid growth coupled with dropping margins and saturation in the higher end of the consumer credit market has meant that banks have consciously expanded into sub-prime markets. This strategy has reaped rich dividends for organizations that have deployed tools to accurately measure and manage the risk in these segments.

Retail credit scoring models are the most accurate tools available to measure the risk embedded in existing and prospective customers. They can efficiently segregate poor credit from good quality credit. Armed with a score that quantifies the default likelihood of a customer, banks are in a much smarter position to decide whether or not to take the risk on book and if yes at what price point. Credit scoring models are built through a range of sophisticated techniques are many times more accurate than judgmental models. In a recent deployment at a leading financial institution our models were able to bring down default by over 50% without bringing down the approval rate.

Banks have realized that the most effective way to increase revenues and profitability is by deepening relationships with existing customers.



Customer Value Management

Acquiring new customers is becoming tougher and more expensive. Banks have realized that the most effective way to increase revenues and profitability is by deepening relationships with existing customers.

Informed account management is critical for managing profitability of existing customers. Account management requires micro-segmentation of your customer portfolios along multiple behavioral dimensions, so that customer needs may be identified and customer segments may be handled based on their needs.

Studies show that 40% of card accounts are inactive, 15% are light users and another 5% are bad credit risks. Therefore about 60% accounts are loss making. Identifying these segments is the first step towards making them profitable. For e.g. inactive accounts and light users can be made profitable by implementation of activation programs. Risky customers can be handled better through active limit management.

Similarly, active management of profitable accounts through recognition programs and spend programs can enhance profitability and loyalty. Understanding the distinct needs, buying behavior and attitudes of existing customers is necessary to undertake the right cross sell and up sell programs. Linking these insights with the economics of the customer relationship can help banks focus their customer management budgets at the right target segments.

Proactive identification of likely attriters combined with proactive retention programs can add millions by way of incremental customer revenue.



Customer Retention

Research shows that acquiring a new customer can be 7 to 8 times more expensive than retaining an existing customer. Also since customer acquisition costs are very high, in domains like the credit cards industry, a new customer often does not become profitable up until two years from the time of acquisition.

Clearly, attrition is costly business.

While improving customer service and developing smarter products will improve overall customer retention, segments of customers will continue to shop around. A critical component of customer retention, therefore, is the capability to sharply identify customers that are most likely to leave your franchise in the near future and then reach out to them immediately. Predictive analytics provides the power to assign the likelihood of attrition to existing customers. Banks can then identify the profitable customers amongst those that have a high likelihood of attrition and implement programs to proactively retain these valuable customers.

Proactive identification of likely attriters combined with proactive retention programs can add millions by way of incremental customer revenue.

Active account management not only impacts credit risk and default but can also be a great tool for generating profitable growth.



Customer Retention

Active management of account risk is critical especially with revolving and open lines of credit like credit cards. Active account management not only impacts credit risk and default but can also be a great tool for generating profitable growth.

Customer transaction history and payment behavior provide powerful insights into the customer credit worthiness. Behavioral scoring models allow card issuers to assess customer risk on an on-going basis helping them balance the fine line between prudence and growth.

Limit enhancements for the right accounts can result in higher spends leading to higher transaction fees and revolve charges. Proactive limit enhancement also plays a strong role in fostering customer loyalty. Curtailing limits on the risky accounts can prevent potential credit losses.

Similarly, banks can provide finer risk based pricing to customers based on their behavioral risk scores. Customers with a good credit history can be provided a better price and vice versa.

As banks use past customer information to better understand the risk and potential of their customers their capability to service and retain customers will increase dramatically.



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