



Account Management for Risk or Profit?

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TOPICS

- **Background**
- **Measuring Profitability**
- **Analysis and Strategy Design**
- **Results**
- **Summary and next steps**



Background: Business Issues

- ◆ Traditionally Risk Driven
 - ◆ Strategy objectives driven by risk
 - ◆ Department objectives in risk terms
- ◆ Non acceptance of high risk strategy
 - ◆ Historic higher bad debt
 - ◆ Objectives driven by bad debt not profit
 - ◆ Recent liquidations due to bad debt in SA
- ◆ Profit different from risk
 - ◆ Requirement to prove the principles through a stepped process



Champion/Challenger Strategies

- ◆ TRIAD™ has been used within SA marketplace on retailers since 1995
- ◆ Experienced TRIAD™ Users
- ◆ Best Practice expert driven strategy
- ◆ Cut-offs at level of risk that the company was comfortable with using joint odds
- ◆ Use of batch bureau score (rescored every 3 months), attrition score, propensity to spend score
- ◆ Higher risk strategies previously ran, not rolled out



Measuring Profitability: Key issues

- ◆ Calculated at the account level
- ◆ True retail revenue streams
 - ◆ In SA we have used the Gross Margin
 - ◆ Business profitability not credit profitability
 - Credit as separate profit centre
 - Securitised portfolios
 - ◆ Future write-offs (from end performance point)
 - Markov chains approach (using transition matrices)
 - Bad debt % by delinquency bucket
- ◆ Measurement period
 - ◆ Originally 12 months



Measuring Profitability: Key issues

- ◆ When monitoring strategies removal of bad debt incurred previous to strategy roll-out
 - ◆ Removes bias in the test groups
 - ◆ Significant differences in variables with low volumes (higher delinquency states) will significant impact on costs
- ◆ Account costs (e.g. collections)
 - ◆ Per cycle (based on strategy assigned)
 - ◆ Per action



Definition of Profit Model

◆ Revenues:

- ◆ Gross margin
- ◆ LCP
- ◆ Interest

◆ Fixed Costs

- ◆ Operating costs
- ◆ Advertising / global marketing costs
- ◆ Account costs



Definition of Profit Model

◆ Account Level Costs

- ◆ Credit services
- ◆ Strategy specific costs
 - ◆ Credit line communication method (by strategy and action)
 - ◆ Marketing communications (by strategy and action)
 - ◆ Delinquent collections (by cycle and action)
- ◆ Card replacement costs
- ◆ Statement cost
- ◆ Bureau Score (FatMAN schedule)
- ◆ System costs
- ◆ Agency commission
- ◆ Actual write-offs
- ◆ Forecast write-offs(minus the 'provision' at the start)
- ◆ Cost of funds



Analysis and Strategy Design Objectives

- ◆ Optimise credit limit strategy in terms of profitability
- ◆ Ensure minimum exposure
- ◆ Identify areas (based on TRIAD™ decision keys) where one strategy is more profitable
- ◆ Develop hybrid strategy that increases overall profit by forming a composite of the different strategies

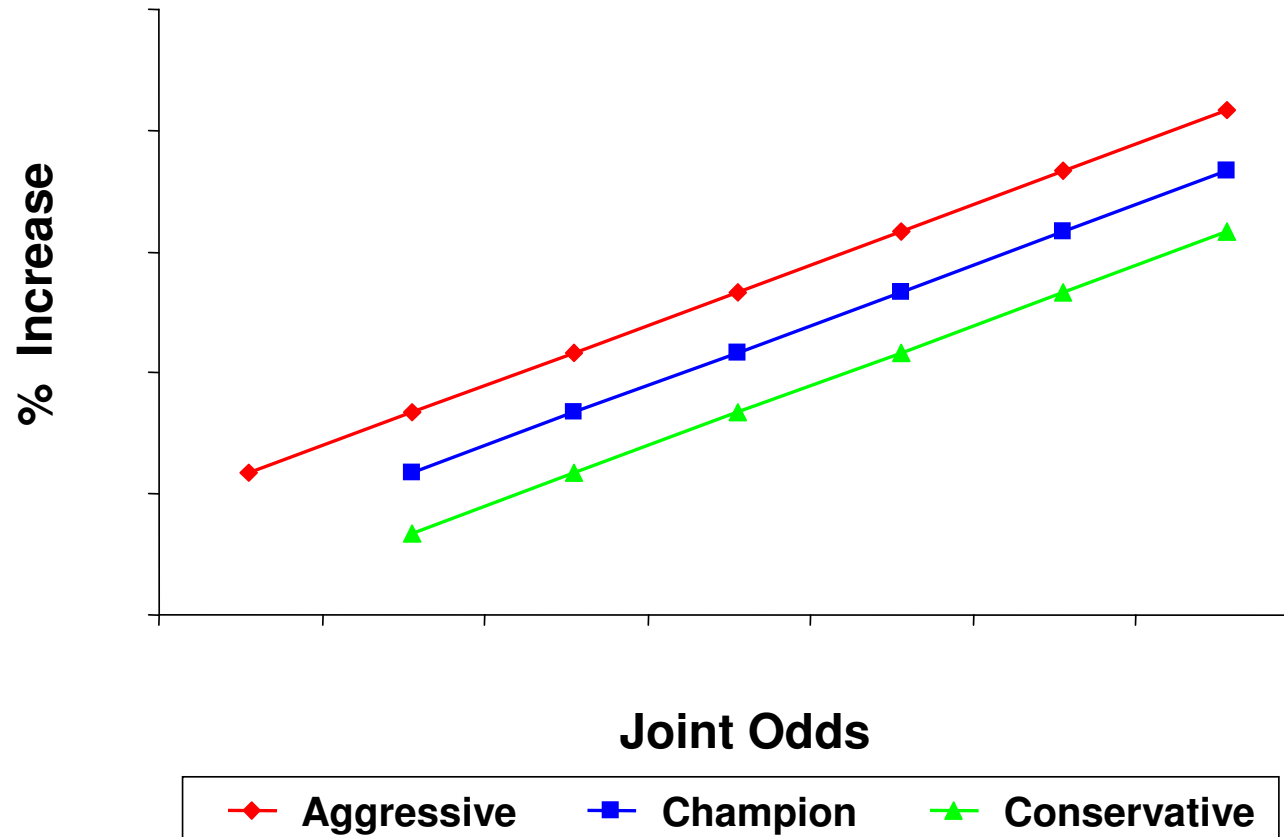


Design of Initial Challenger strategies

- ◆ Two credit limit strategies implemented to be tested against the champion
 - ◆ Aggressive challenger
 - ◆ Conservative challenger
- ◆ Initial aggressive strategy based on profit joint score matrix
 - ◆ New areas to give increases
 - ◆ Higher increases for mid range scores
- ◆ Each strategy implemented on 15% of the population selected by random digits (checked for homogeneity)

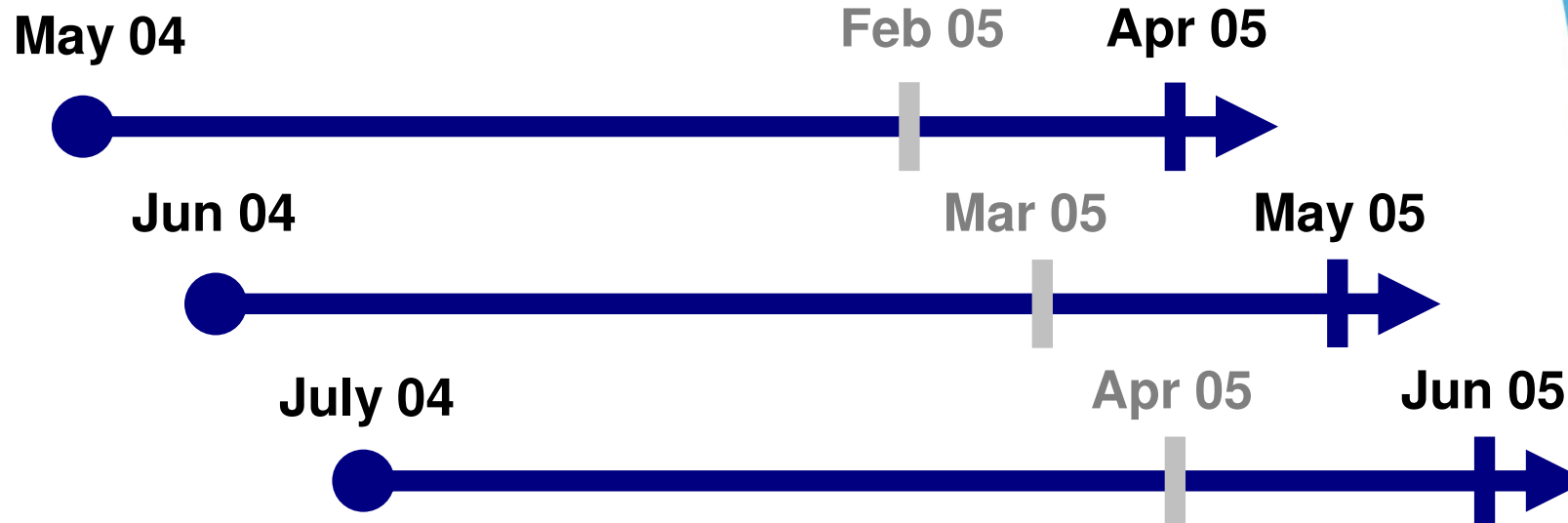


Credit Limit Strategies





Performance Window



- ◆ Starting point of performance measurement based on the month an account was eligible for a credit limit increase
- ◆ Profit measured over 10 months and checked over 12 months when data available

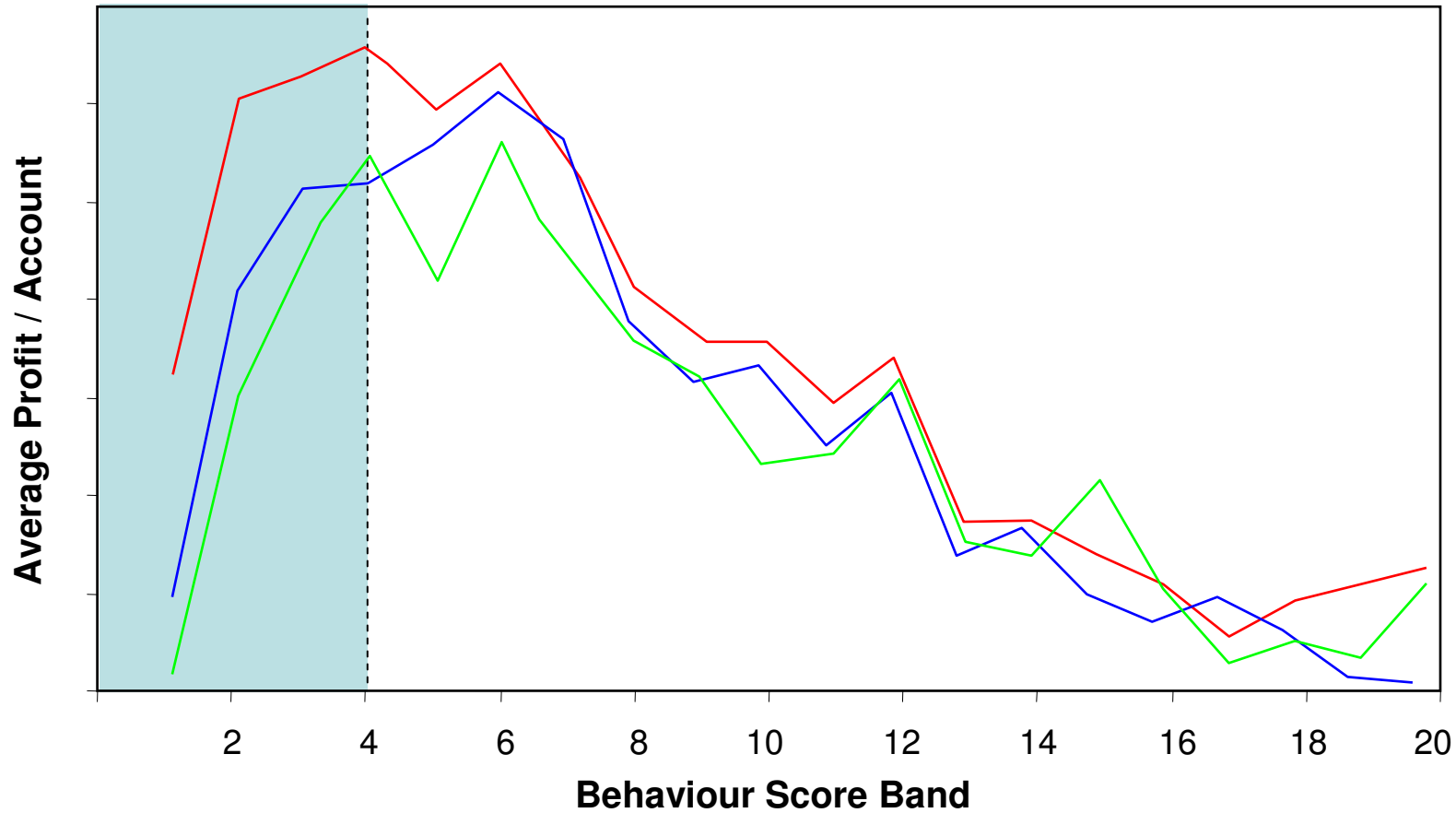


Impact of Decision Keys on Profitability

- ◆ **Objective:** To determine main differentiators of profitability among the three strategies
- ◆ **Technique:** Significance testing on equal volume bands within each decision key
- ◆ **Method:** Analysis of variance using Tukey's Studentised T-Test at 95% confidence level



Example: Behaviour Score



—◆— agg —■— cha —▲— con

Aggressive significantly higher

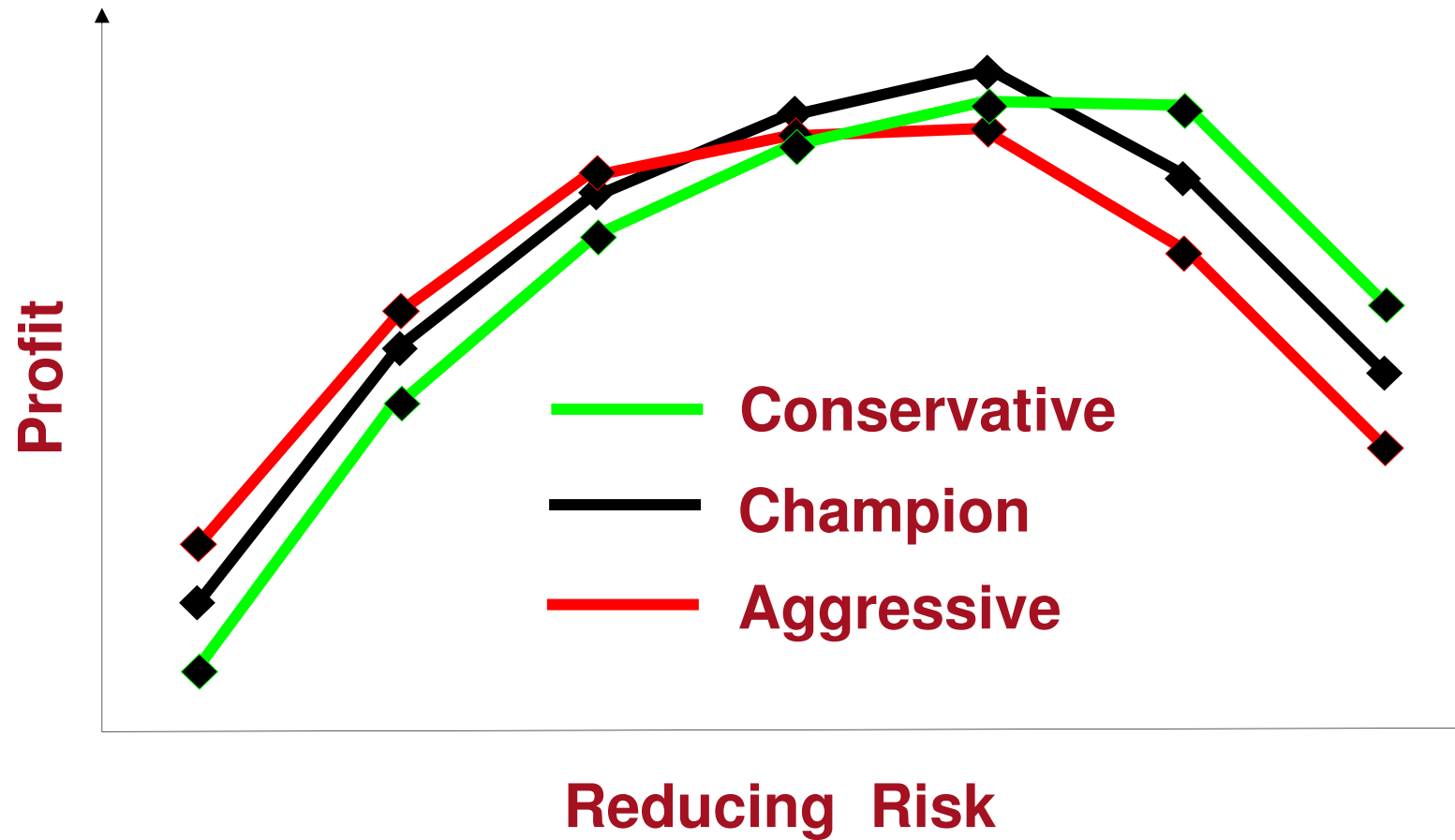


Impact of Decision Keys on Profitability

- ◆ Aggressive strategy most profitable overall
- ◆ Hybrid strategy had to achieve higher profit than aggressive challenger
- ◆ Analysis carried out for all decision keys available within the decision area
- ◆ Five initial keys selected
- ◆ Each key was analysed individually and in combination with other keys to determine potential profit

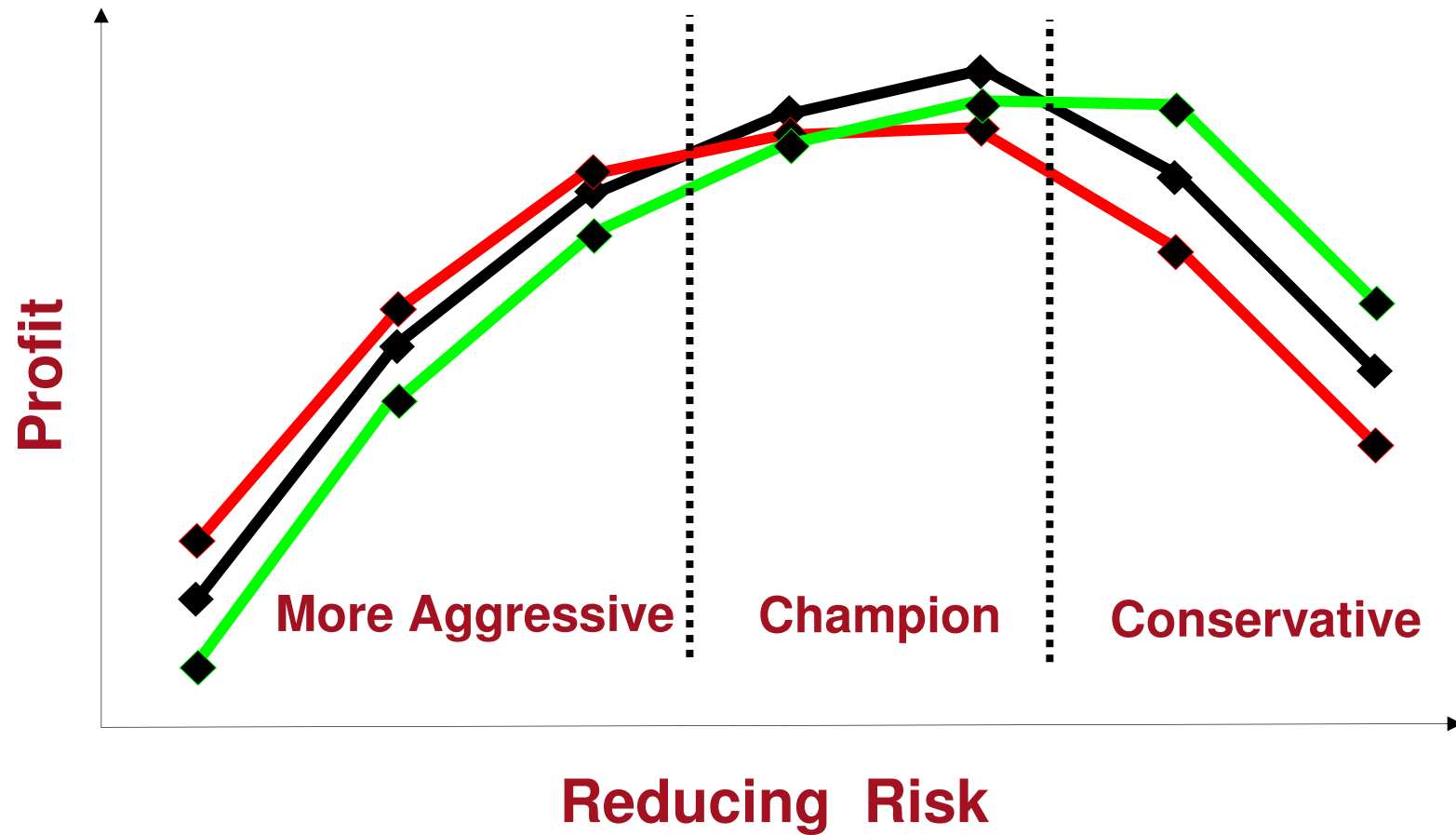


Analytic Strategy Design



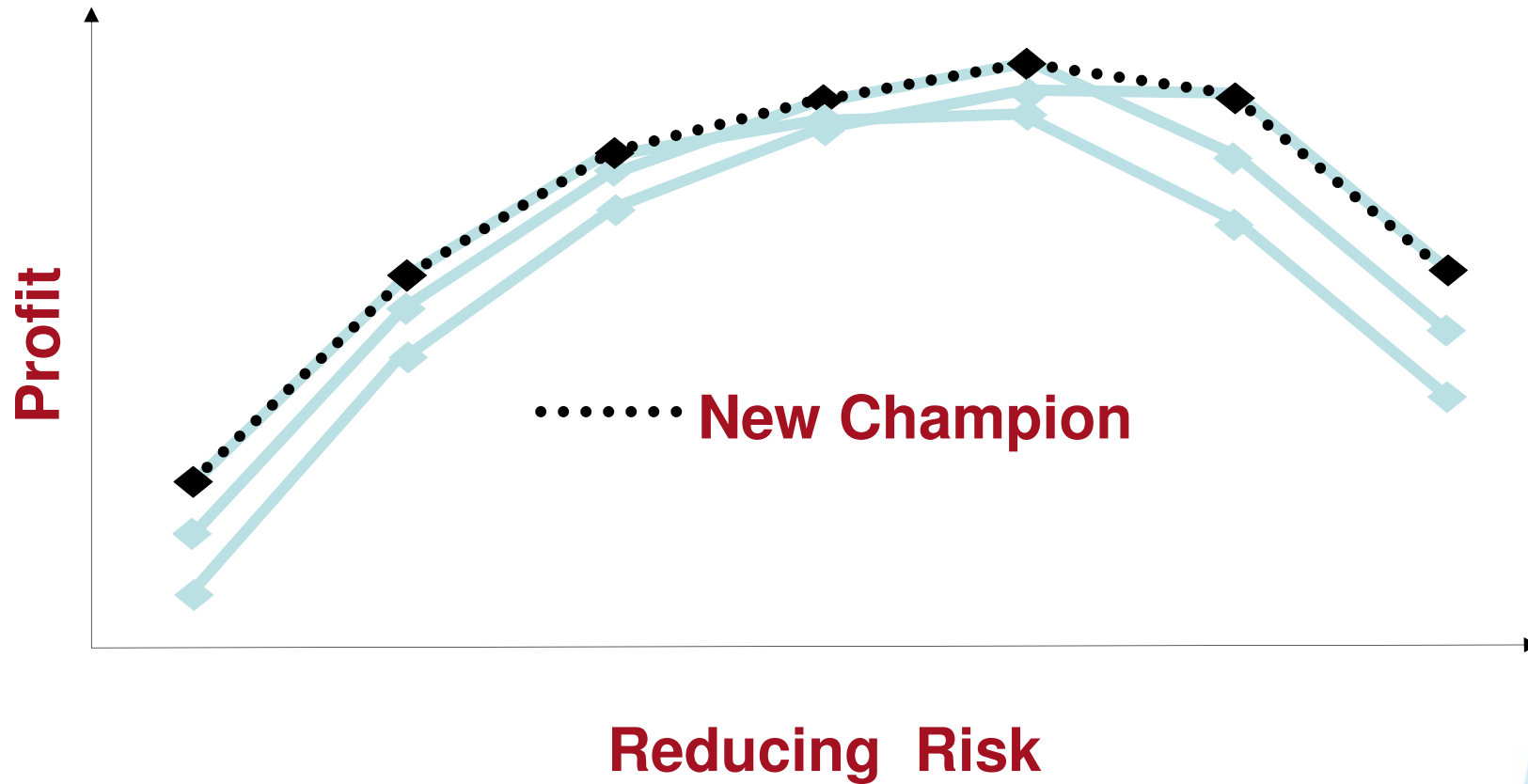


Analytic Strategy Design





Analytic Strategy Design: Final strategy is composite of tests





Results: Profit Comparison 12 months performance

Hybrid 1

Strategy	Difference from champion
Hybrid	5.07%
Aggressive	4.25%

Hybrid 2

Strategy	Difference from champion
Hybrid	5.74%
Aggressive	4.25%



Summary and next steps

- ◆ Implemented hybrid strategy (potential increase in profit 5.7%)
- ◆ Strategy and department objectives have been modified
- ◆ Acceptance of higher risk strategies
- ◆ All Champion/Challenger testing is now measured by profitability
- ◆ Next Steps:
 - ◆ Require more aggressive challengers
 - ◆ Incorporate optimisation techniques to the analysis for maximizing profit



Q&A

