

Balancing risk and profitable growth

One of the most important aspects of any lending portfolio is the ability to manage risk, and decision analytics plays a critical role. **CI** spoke to Marc Gaudart, senior vice-president of Experian-Scorex, part of global information intelligence provider Experian, about the use of decision analytics in consumer lending

Decision analytics, which encompasses techniques such as credit scoring, is a vital tool in enabling lenders to manage risk in their portfolio. It is as important in emerging markets, which are keen to embrace consumer credit in the same way as some of the more mature countries did 20 years ago. **CI** discussed this and other industry issues with Marc Gaudart, senior vice-president of Experian-Scorex, the decision analytics business of Experian.

CI: Do you see significant changes in consumers' attitudes to credit?

MG: "In 'old' continental Europe, there are still a lot of issues to do with educating people about the benefits of consumer lending. Meanwhile, the challenge in 'new' Europe is about managing growth and risk.

"I'm concerned about the growth levels and bad debt potential in some of these newer credit markets. Many players have a credit scoring infrastructure in place, but there is huge pressure on lenders to grow their business faster. Multinationals, on the other hand, know that risk management is important. They have it ingrained in their culture. There are managers in these organisations who have lived through good and bad times. That's why our clients, such as GE Capital in China, are keen to have decision analytics and credit scoring tools in place.

"On the other hand, a lot of managers in local banks in Central and Eastern Europe and China have never seen a bad credit cycle – unlike South Korea, for example, which experienced an explosion in bad debt in the early days of its development of a consumer credit market, and has now warmly embraced credit scoring. We spend a lot of time with our clients to devise credit policies and to help them manage bad debt proactively."

CI: Major credit markets such as the US and UK are facing high levels of consumer debt. Has this been exacerbated by many UK mortgage lenders now lending based on affordability rather than salary multiples?

MG: "Our view of the bad debt problem in the UK is that it is largely an affordability

and indebtedness issue, more than a delinquency issue. In the UK market Experian has now launched affordability scores in addition to our traditional delinquency scores to help lenders with both issues. Affordability scoring is part of the solution, not the problem. The high level of impairments that UK banks will report in their 2006 results is going to be very high.

"Banks used to look at debt and previous delinquency in terms of how much the customer wanted to borrow. Now they tend to look at the level of debt compared to income in order to identify those customers who are likely to be over-indebted.

"However, when a bad debt problem hits a lender, it's too late to invest in a solution. Lenders need short-term measures to recover quickly. For existing customers, these could include limit management to tighten credit lines, and for new business this could include using affordability as one of the criteria, and being smarter in how lenders go about deciding credit limits and who they lend to."

CI: Do you expect to see more banks using credit bureau data for marketing purposes?

MG: "In some markets like the United Kingdom, there are restrictions on how this data can be used. We need to distinguish between lenders marketing to their own customer base and marketing to new customers.

"Within organisations, we have seen a cultural change in how lenders market across products. Traditionally, banks operated in product silos, each with their own marketing budgets. These would often be going after the same clients. Now they're asking, 'Based on the marketing budget I have, should I sell a loan or a credit card to this customer?' This is still an emerging trend; however, those doing it successfully are seeing up to 30 to 40 per cent increases in customer response rates."

CI: What role do collections play in managing levels of consumer debt?

MG: "Collections are a big issue, especially in emerging markets, and it is needed from day one. A lot of collection work in emerging markets is around educating consumers. Once they've used a credit card or taken out

a loan, many consumers don't know how to repay the balance. The fraud aspect here is also important: you don't handle in the same way a first payment default and someone who has been a good customer for years and who has just defaulted. Segmentation and profit-driven collections strategies are the key drivers of a good collections process."

CI: What do you see as the next major development in credit scoring?

MG: "Managing lending portfolios for profit is becoming increasingly important. It aims to bring both the marketing and credit drivers together to decide how best to define the amount to be loaned, price, loan duration, etc. With the technology in place, lenders can reach a better decision on the most appropriate products to spend their marketing budget on, and what specific terms of the offer would maximise profits. So credit scoring is not just about ranking customers any more, but about optimising all credit decisions for profit."

CI: There are some potentially huge markets for both local and multinational consumer lenders, especially in the BRIC countries (Brazil, Russia, India and China). How important are these markets for Experian?

MG: "We see the BRIC countries as having enormous potential as their consumer credit markets develop and grow, often with our help to ensure that they develop profitably and in a sustained manner. We've been in the Chinese market for 18 months already, and a number of clients are already using live Experian systems. We have also opened an office in Beijing.

"The whole Asia-Pacific region is important to us. We have helped banks in South Korea come out of the bad debt crisis and we've also seen a lot of recent successes in Japan. We've been able to help clients with automated decision tools. We also have a big base of customers in Russia and have been in Brazil for over ten years. Experian has also helped a lot of clients to grow their lending portfolios across Spanish-speaking Latin America, especially in markets such as Chile and Argentina." ■