Prevention is better than the cure
The role of a pre-delinquent strategy in managing bad debt

Forward thinking lenders are considering whether ‘prevention is better than the cure’ and are making the transition from this reactive collections environment to one that incorporates a proactive stage aimed at pre-collections activity to try and reduce the flow of cases into the collections system.

Pre-delinquency strategy is the practice of proactively identifying and contacting customers who are currently up-to-date and are not yet debtors, but have a predicted high risk of becoming delinquent in the near future.

The aim is to aid identification of customers likely to become delinquent and target appropriate actions that:

• **Encourage payments** – ahead of potential delinquency
• **Minimise ‘at risk’ exposure**
• **Manage potential high risk debt** – by sensitive treatment of customers at an earlier stage of the process

**Benefits of proactive collections**
There are a number of benefits of taking this proactive pre-delinquency approach:

• Reduction in number of accounts moving into ‘true’ collections
• Significant reduction in provision for impairment
• Trade-off of successful preventative costs compared with longer term unsuccessful collection costs
• Keeping profitable accounts live
• Driving up customer lifetime values
• Demonstrating sensitivity and offering advice when most needed
• Compliance with regulatory guidelines to ensure fair treatment

To ensure that these benefits are achieved you should implement process changes as a champion/challenger test and on relatively low volumes. Once the business case has been demonstrated, a further investment in pre-delinquency management can be justified and the full benefits achieved.

This guide will give you steps to develop your own proactive pre-delinquency strategy.

**Dealing with financial difficulties**
The standard, and typical reactive collections approach, is to use the first missed payment as the initial trigger to initiate contact strategies. Likewise, customers who have financial difficulties rarely volunteer that they are struggling and typically try to avoid contact once a payment has been missed.

The alternative is to consider what preventative action can be taken with a customer before the payment has been missed and to help handle the longer term exposures. The primary objective therefore should be to predict and pre-empt delinquency so that appropriate steps can be taken which would prevent the customer becoming delinquent and, if this cannot be avoided, manage the relationship with the customer and reduce the exposure to the lender.
Strategic framework for preventative collections actions

To implement a pre-delinquency strategy there are four key steps that contribute to an accurate assessment of the customers' circumstances and guide the potential actions that need to be taken.

In the pre-delinquency environment careful management of this process is particularly vital, as the customers are all still ‘good’ customers and any misalignment of message or approach with their circumstances could potentially damage good customer relationships and lead to a loss of business.

The framework embraces four key requirements:

- **Data and data cleansing** – Knowing your customer
- **Analytics and data intelligence** – Understanding your customer
- **Strategy and segmentation** – Targeting your customers
- **Workflow and process management** – Interacting with your customer.

**Knowing your customer**

For many organisations the internal information is the only perspective they have on an individual customer. Some of this information is provided at the point of application and may be out-of-date. However, it will include data that, if still valid, will allow affordability to be assessed as well as a risk of default score.

Many organisations continue to use this view in their ongoing risk assessment procedures on the assumption that, either changes have not occurred, or that they have minimal impact. The reality is that this information alone is insufficient for a pre-delinquency strategy to be effective, as circumstances do change, can be drastic, and fairly rapid.

The identification of changing behaviour patterns that are indicative of financial difficulties - before a missed payment occurs - is vital if a business is to make an early proactive intervention.

External data can play a vital role in ensuring that the contact strategy will have a high degree of success, by ensuring that you have the most accurate data for communications purposes.
Understanding your customer
By using internal and external data, you can develop a powerful predictive score that identifies potential pre-delinquency.

This example below, shows a bespoke score that was targeted to identify currently up-to-date customers who would miss a payment in the next two months.

At one end of the spectrum the risk of the customer missing a payment in the next two months is very low - less than 3% of this group is predicted to default. At the other end, over 50% of this group is at risk of missing a payment. It is this group that would be targeted by pre-delinquency activities.

In this case of such a high risk group, the time advantage of taking action on a customer one or two months ahead of a missed payment potentially allows lenders to reduce the flow of cases into formal collections, minimise exposure at default and support the retention of customers who will be valuable in the longer term.

Targeting your customer
The objective of the targeting process is to enable lenders to segment the pre-delinquent customers into groups for an appropriate contact strategy, based on their risk of becoming delinquent, the size of the balance at risk and their value to your organisation.

This ensures that communication is matched to the customer so that the contact is relevant and supportive. As the customer has still not missed any payments with the organisation a light customer management approach should be taken.

At the heart of a pre-delinquent strategy is the offer of financial advice and guidance for the customer. The provision of advice in the form of printed documents, self-service websites such as Experian Smart Collect 24/7, and financial health checks provide an opportunity for those customers under financial pressure to either take their own steps to ‘self cure’ or to proactively engage with the lender to discuss how they might resolve their current, but as yet undisclosed, financial difficulties.
Interacting with your customer

Best practice in pre-delinquent collections is to create dedicated teams to deal with customer interaction. These teams need to be trained to talk to customers about their financial situation, and effectively use information about customers who have a high potential for becoming collections cases. It is better practice that the resource is drawn from within the collections operation, rather than relying on a customer service team.

Conclusion

The benefits of adopting a pre-delinquent strategy for collections is self-evident: if earlier intervention can prevent cases entering collections in the first place, the collections workload will be lower and bad debt write-offs will be reduced. In addition, it is an opportunity to build strong relationships with customers for more effective collections actions if necessary, protecting future revenue streams as well as fulfilling the requirements of a responsible lender.

In practice, achieving these benefits needs careful planning and the ability to access the right data, both internally and from the bureau, and use it effectively to enable the accurate targeting of at risk customers.

Ultimately the rewards can be high and payback can be extremely rapid. If just 5% of customers can be prevented from entering collections without increasing the size and workload of the collections team, then the value to the business in terms of reduced write-off and future profit from retaining customers will be dramatic.

For more information about you can develop a successful pre-delinquency strategy, please contact your Account Manager, or email: CreditServices@uk.experian.com

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