Predictive Power & Profitable Relationships

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Small business continues to serve as the growth catalyst in the U.S. Economy. They employ over half of all private sector employees and create somewhere between 60-80% of all new jobs. Small business owners' confidence in the national economy rose 8 percent year over year – from 40 percent in spring 2014 to 48 percent in 2015. This continued optimism and focus on growth creation present a great opportunity for financial institutions desiring to build long term, profitable and sustainable relationships.

In order to thrive and scale, small businesses need to build a strong relationship with business lenders. Working capital is the lifeblood of small business growth; it empowers investment in people, assets and innovation. As more small businesses seek business credit, the challenge for lenders is how to effectively balance opportunity and risk. The vibrancy of the market, the sheer number of small businesses and the broad spectrum of business types make innovation and best practices a competitive imperative. This whitepaper examines key strategic issues that face lenders looking to penetrate and thrive in this critical lending market.

MARKET LANDSCAPE[1]

> "Nearly two-thirds (63 percent) of small business owners expect their revenue to increase in the next 12 months, compared with 68 percent a year ago. One in three small business owners (31 percent) expect their revenue to stay the same in the next 12 months, up from 26 percent a year ago," according to a recent Braun Research Report.

The positive trend is supported by data from Dun & Bradstreet's U.S. Economic Health Tracker that illustrates overall delinquency on small business credit continues to improve significantly. While there is some trepidation about continued prosperity, the small business sector continues to be vibrant and growing.

For major financial institutions, the pressure to expand their small business portfolio while maintaining profitability is significant. Interest rates are at historic lows and lending approval rates are up, so effective risk mitigation and small business cultivation present a direct opportunity to expand profits. Financial institutions can become more sophisticated in their portfolio management process and deliver improved profits by introducing three key elements: single, complete view of entity, predictive insights and innovation.

[1] Braun Research BofA Small Business Owner Report

MORE DATA & MORE TRANSPARENCY = IMPROVED PREDICTIVENESS & PERFORMANCE

Beyond the typical identity data, firmographic data and payment history, new and highly predictive attributes are available today to help lenders build more profitable relationships.

–Credit Card Data
–Loans
–Small Business Payment Performance
–Credit Line Utilization
–Balance Velocity Ratio
–Activity 'Signals'
–Fraud Triggers
–Spend Behavior
–Search Inquiries
–Sentiment Data
–Behavior Data
–People Data
–Shipment Data

TRANSPARENCY: THE POWER OF A SINGLE, COMPLETE VIEW

For lenders, the framework for long-term portfolio profitability starts with underwriting and origination. Transparency into the creditworthiness of any small business and understanding their total debt exposure is vital to avoid payment delinquency and profit-eating write offs. Lenders today can look beyond payment performance to a broader spectrum of new data elements - company family trees, activity signals, credit line utilization, balance velocity ratio, fraud triggers and spend behavior. It is critical that lenders delve deeper into a business to provide significant guidance for credit line assignment. Transparency into a small business will also assist in removing high-risk applicants from the origination pool and provide insight for line expansion and growth strategies.

POWER OF PREDICTIVE INSIGHTS

The massive number of small businesses and the huge amount of data available make predictive modeling an invaluable tool for effectively managing portfolios. Automated approval models and portfolio risk forecasts are two examples of best practices being deployed by lenders. Newly derived attributes and new risk models are delivering significant predictive lift over standard data and older models. This unprecedented improvement will significantly impact risk discrimination and contribute to bottom line performance.

Lenders can experience at least 20% predictive lift over standard risk scores resulting in improved risk discrimination and profitability if they evaluate and leverage a subset of 600+ new and highly predictive attributes measuring:

–Payment and balance **velocity**

–Minimum, average and maximum **balance ratios**

–**Time series** of changes in payment and balance

Predictive modeling is particularly essential for lenders dealing with increasing portfolio complexity. Lenders cannot only identify accounts that show early signs of credit decay, but they can maximize penetration and growth with existing customers. Lenders can also segment accounts according to probability of collection and prioritize those accounts for collections. The rise of macroeconomic modeling, industry benchmarking, and long-term forecasting also helps lending institutions create a more profitable small business portfolio and a significant competitive advantage.

By deploying models, lenders can systematically identify accounts that show early signs of decay and assess the risk of customer bankruptcy in a 12-month window. Lending institutions that combine these new highly predictive attributes with their proprietary portfolio data should experience significant lifts in predictability and asset performance.

THE INNOVATION IMPERATIVE

Innovation has never been a more essential issue for lending institutions. Global financial organizations have been dealing with increasingly complex technology platforms, mobile applications and payment technologies across numerous markets. New analytic “sandbox” solutions can help lenders better understand the risk and volatility within their business landscape and allow them to benchmark their performance against peer lenders. In order to stay competitive with this evolving landscape, the time is now for banks, business lenders and credit unions to test new methods of portfolio, relationship and decision management.

Serving small business brings the need for innovation directly to the forefront. Innovations such as newly derived attributes and emerging risk analytics will empower lenders and their teams to more effectively serve the market, optimize financial performance and effectively manage risk and opportunity. Lending institutions must continue to develop tools, systems and processes in order to effectively manage individual relationships and lending portfolios.

DELIVERING PROFIT

The primary reason lending institutions should embrace this new landscape of integrated data models and advanced analytics is improved bottom line performance. Adopting these best practices results in improved profitability in very tangible ways.

–Maximizing approval rates while avoiding high risk applicants
–Removing high risk applicants from the lending pool
–Optimizing line size for each business
–Improving risk mitigation by automatically identifying accounts that show early signs of decay
–Maximizing growth with top performing small businesses

In this highly competitive marketplace, the small business market will continue to be a key part of any lending institutions portfolio. Lenders will improve their bottom line if they leverage new, highly predictive attributes and emerging risk analytics across the entire credit lifecycle – loan origination and underwriting, account management and portfolio monitoring, collections and recovery. Bottom line, full transparency into a small business, robust predictive modeling and continued innovation will yield improved results for the organization.