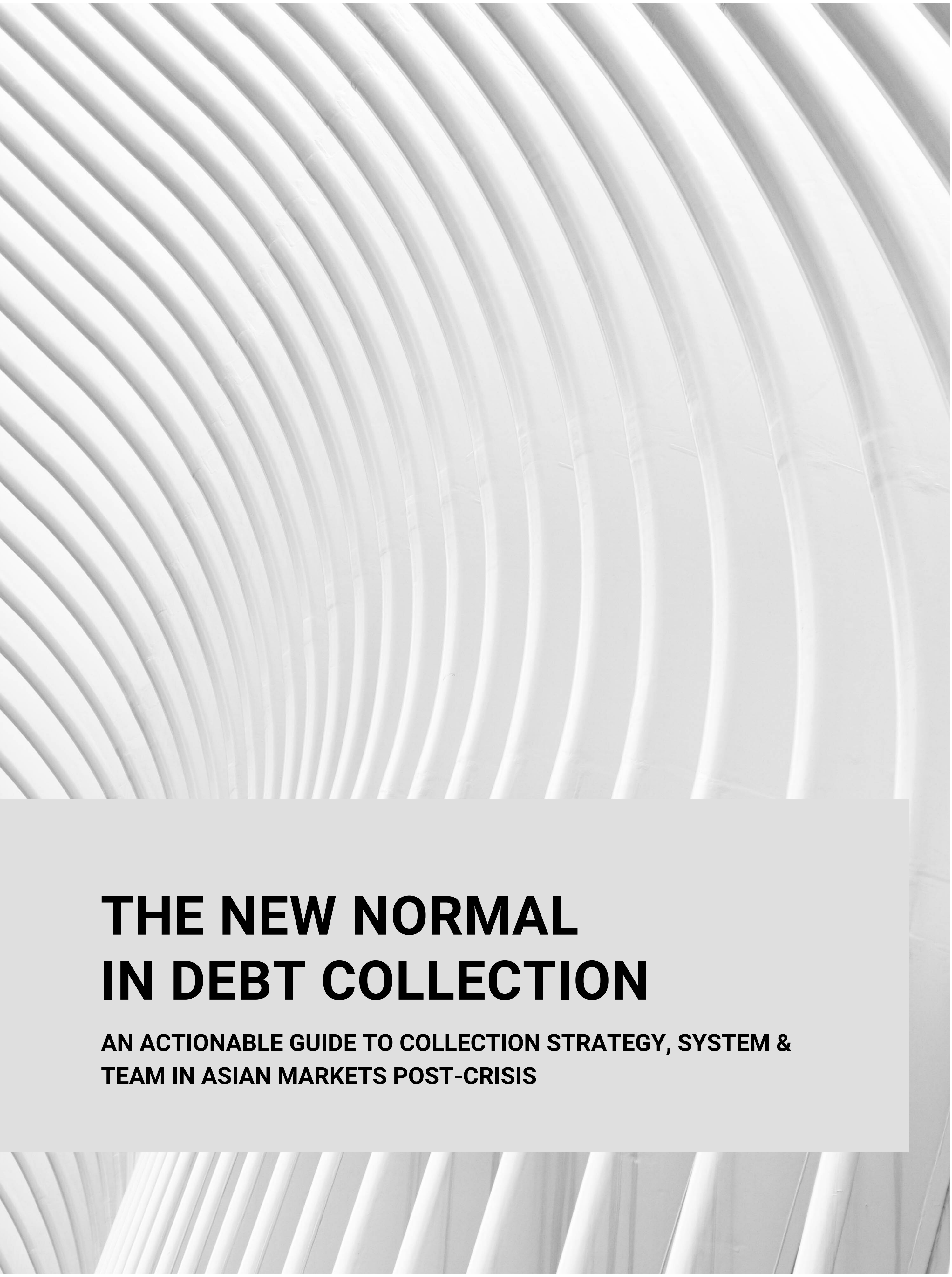

THE NEW NORMAL IN DEBT COLLECTION

AN ACTIONABLE GUIDE TO COLLECTION STRATEGY, SYSTEM & TEAM IN ASIAN MARKETS POST-CRISIS

JUN 2020

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EXECUTIVE SUMMARY

This whitepaper examines the challenges that define debt recovery during an economic crisis and solutions lenders should adopt to evolve and restructure their collection process while acknowledging the change in borrowers' payment behaviour during uncertain times.

In the ongoing crisis, macroeconomic pressures kick in with record-breaking unemployment rate across the world. Many consumers find themselves to be in financial distress for the first time, unable to pay back their loans. This cause a surge in Non-Performing Loans (NPLs). The increase in NPLs combined with the urgency to improve collections has prompted financial institutions to update their current collection system and processes before more borrowers roll into the later delinquency buckets.

Debt collection in emerging Asian markets is still largely manual, requiring a huge investment of time and effort. While these methods were sufficient in the past, lenders can no longer rely on legacy systems and strategies to retrieve loans effectively.

Lenders need to fuse new technologies and approaches that were previously unavailable such as developing more refined customer segmentation and contact strategies, improving the emotional intelligence of call agents, and tailoring communication messages such that they address the unique issues facing each segment.

MACROECONOMIC PRESSURE

The global credit sector is one of the many critical components that support economic growth. Nowhere is the role of lenders in economic development more important than in the emerging markets such as India, Vietnam, and Indonesia that are experiencing rapid expansion today. In India, the credit market grew to the highest levels between 2008 and 2010 during the global financial crisis. On the contrary, the growth rate of India's GDP then contracted to about 3%.

While there is clear evidence that lenders become even more critical to the economy, when all is not well, the current region-wide economic slump could spell further doom to the credit market. Unemployment and lost production potential will be escalated, and the unemployment rate will positively correlate to the rate of growth of NPLs.

RISING NPL IN ASIA PACIFIC

Based on S&P Global, non-performing assets and subsequent credit losses in Asia-Pacific banks could rise by $600 billion and $300 billion, respectively. More specifically, India could see an increase of $25 billion with Indonesia seeing a spike of US$6 billion in non-performing assets.

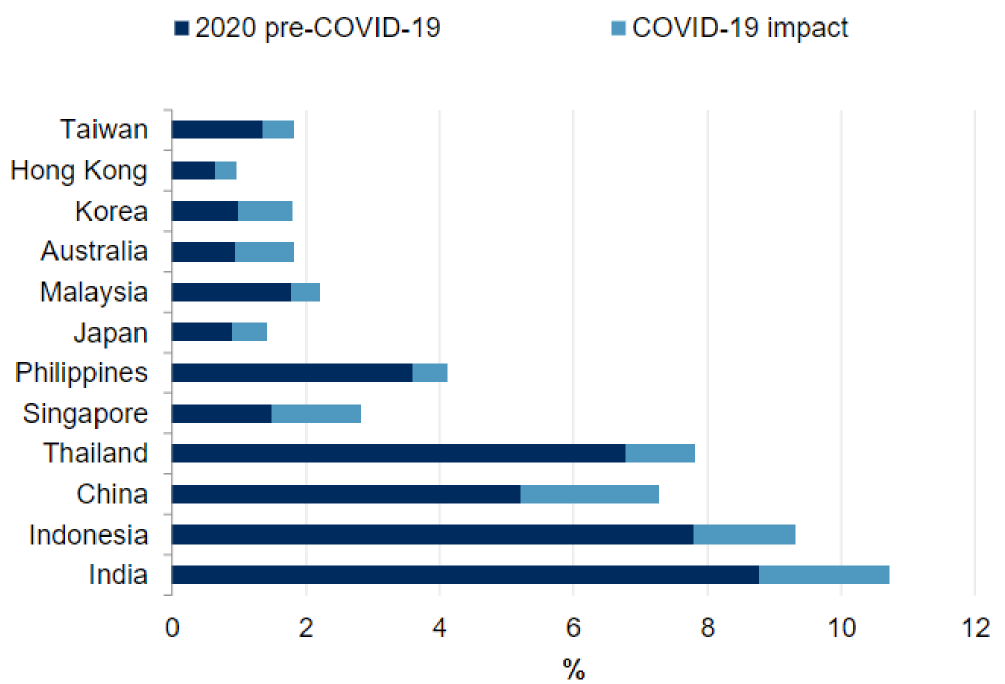

Figure 1 Covid19 impact on NPA ratios in 2020. Source: S&P Global.

In 2018 and 2019, the whole of Southeast Asia was on a comfortable patch as far as GDP growth is concerned. According to figures from the Asian Development Bank, Southeast Asia's GDP expanded by 5.1% in 2018 and later marginally reduced to 4.4% in 2019.

However, the COVID-19 pandemic has inflicted great and instant pain on the region's economies.

The Asian Development Bank estimates that Southeast Asia region's GDP growth will be only 1% in 2020, and perhaps grow to 4.7% a year later. Admittedly, incomes will be heavily impacted in the country, and borrowers could default in droves. Lenders face a grim future in which they might find it taxing to stay afloat. Today, more than ever, lenders need to adopt innovative systems and adapt strategies to navigate the choppy waters.

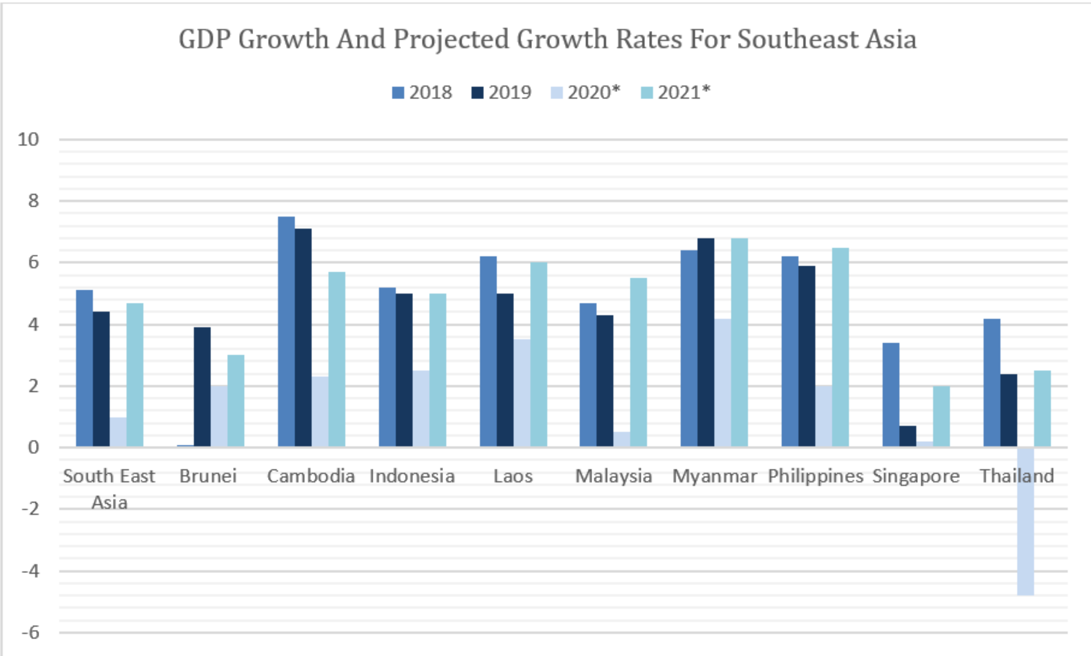

Figure 2 GDP Growth and Projected Growth for Southeast Asia. Source: Center for Strategic and International Studies & Asia Development Bank.

CHANGE IN BORROWERS' PAYMENT BEHAVIOUR

The ongoing economic turmoil is not unique in terms of inducing debt delinquency. Lenders need to understand borrowers' individual cases, focus on their motivation, and relate them to changes in borrowers' payment behaviour.

As shown from the ribbon chart (Figure 3), during the active phase of lockdowns and social distancing, borrowers used "Covid-19 virus" as a reason which emphasizes their uncertainty. In May'20, this converted into an increasing share of "Unemployed" which might be the consequence of economy activities decline.

PROPENSITY TO PAY GOES DOWN

Many borrowers are now experiencing a sudden decline in wages or being let go as a result of COVID-19 led recession, hence their payment propensity has reduced. Some borrowers might be experiencing financial distress for the first time and a large portion of them will roll from regular payments to delinquency.

Therefore, lenders should support this group of borrowers who are likely to repay during normal circumstances and offer payment restructuring for them to tide through this difficult period.

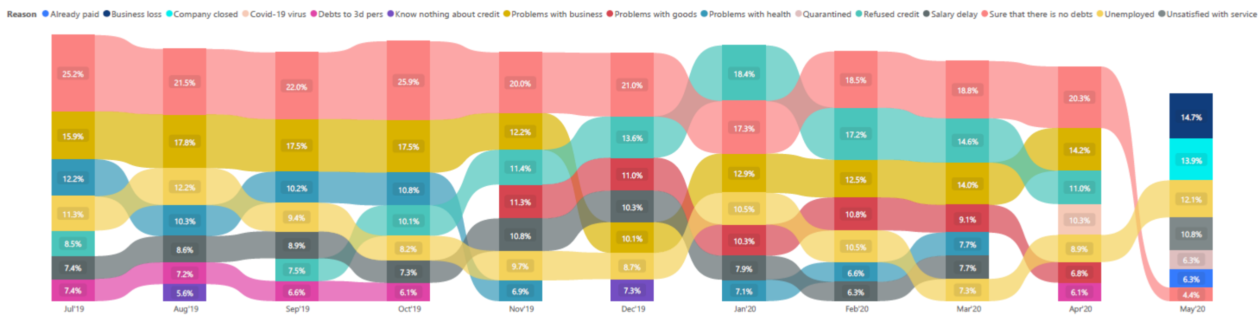

Figure 3 Borrowers' reasons for deferring payment. Source: In-house Risk team.

BORROWERS FACE GREATER UNCERTAINTY

Secondly, borrowers will face greater uncertainty in the times of a crisis. They will find it harder to acquire basic amenities and might need to dig deep into their savings to provide for their daily needs. The dried-up liquidity makes individuals recede into debt delinquency.

In addition, borrowers may also begin to prioritise different loans when repaying to manage multiple financial responsibilities. Their primary concerns will be less on long term repayment strategies, but on access to credit in the interim and minimising interest payments and charges. Moreover, borrowers who missed initial payments of their less prioritised loans are also more likely to roll them forward into later stages of delinquency, and as the default volume goes up, they will find it harder to manage these loans.

Therefore, overall behaviour of the portfolio will change. There will be lower and less recurring contacts. Countries experience an extensive lockdowns and distancing measures which affected the ability of borrowers to fulfill their commitments. Kept promise rates decrease as shown in Figure 4 below. This will affect borrows' promise to pay rate and their frequency of payments. Figure 5 shows a decrease in the share of repeat payers in a month and a drastic drop in May. This could be an effect of income declines and borrowers' reaction on uncertainty caused by crisis. Hence, lenders need to take these metrics into consideration. Financial institutions that are quick to adapt to these changed circumstances will cope best.

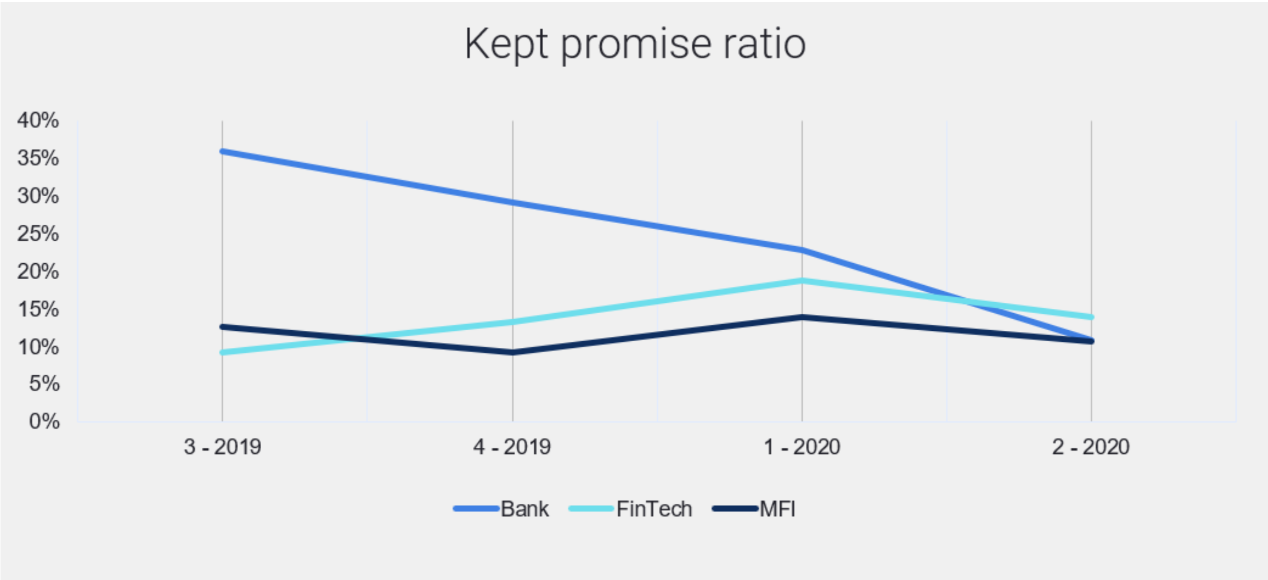

Figure 4 Kept promise ratio among different financial institutions in Asia. Source: In-house Risk team.

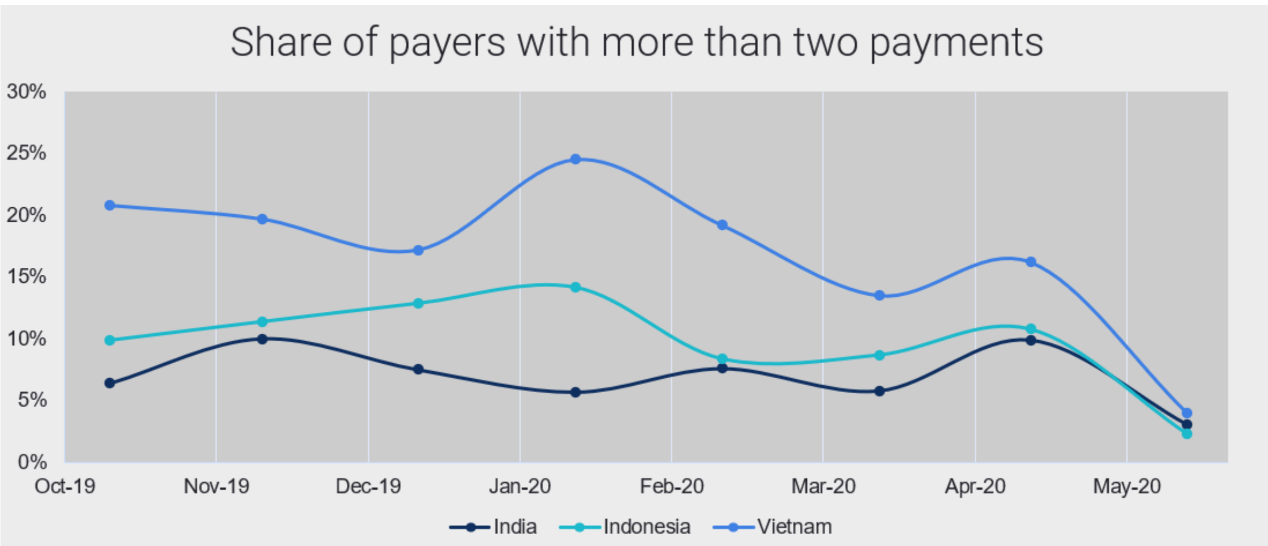

Figure 5 Share of payers with 2 or more payments in a month. Source: In-house Risk team.

Another key metric to look into is the share of repeat contacts with Right Party Contact, RPC (Figure 6). This number decreases from March onward, even for the most prospective contacts. This indicates that borrowers feeling uncertain, try to avoid commitments and observe how their situation unfolds. For collection, it means that the communication strategy should be reconsidered in all areas from channels, messaging as well as frequency.

It is crucial that lenders need to swiftly adjust their collection strategies by adding better decision making in their day-to-day collection, fixing their segmentation models to more efficiently target borrowers based on new delinquency reasons, making collection less human intensive by employing technology and predicting the likelihood to default.

Additionally, financial institutions with a more sophisticated arrangement of interactions by extending communication channels and introducing self-servicing facilities to collection integrated with predictive analytics will fare better than their counterparts during an economic crisis. These unconventional and different communication strategies will provide greater value and engagement to the borrowers through a seamless and stress-free experience of debt settlement.

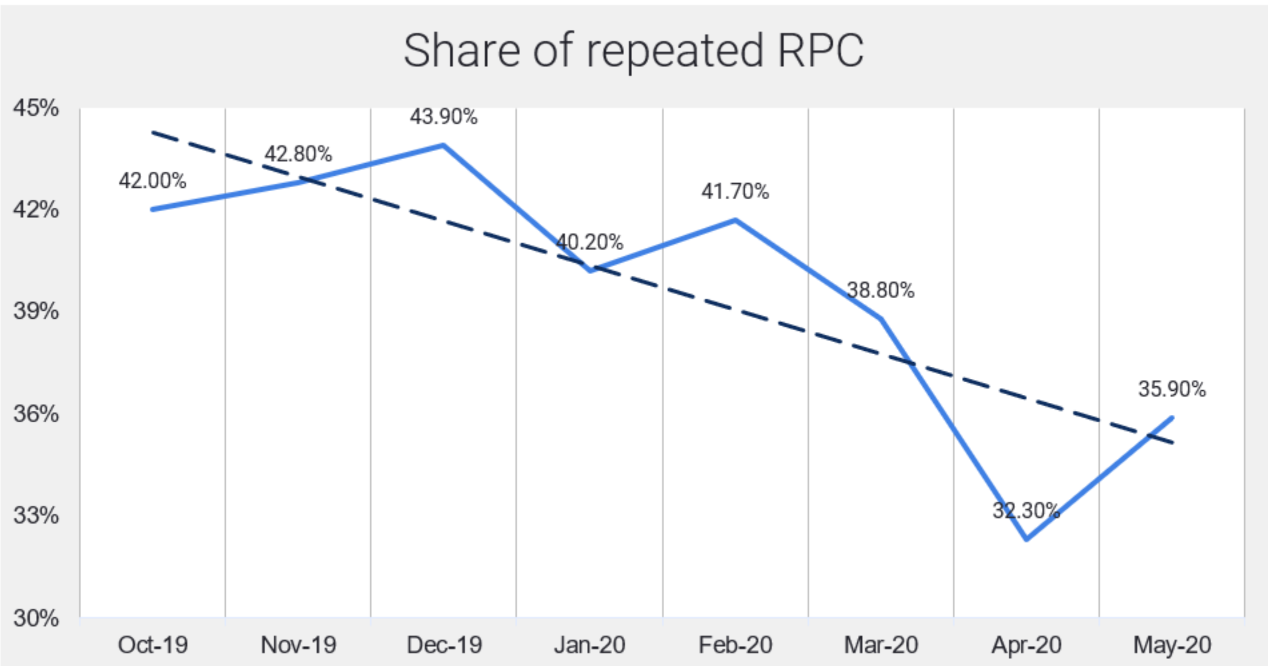

Figure 6 The share of repeat contacts with RPC contacts in Vietnam. Source: In-house Risk team.

DEBT COLLECTIONS IN ASIA TODAY

In much of Asia, debt collection is still largely executed through a one-size-fits-all approach. Irregular business practices mired with a lack of quality, transparent reporting, and a fragmented market where the majority of the debt collection teams primarily rely on traditional processes of human enforcement to collect the debts physically. This makes collection unscalable and inefficient with low tech in-house, requiring a huge investment in time and effort. There is also hardly insights on borrowers' payment behaviours or motivation to customise contact strategies to different segments, leading to less effective recoveries.

Under the COVID-19 cloud, debt collection in all of the countries where manual procedures rein is a thing of the past. Most countries are in lockdown, and movement has been curtailed. Indonesia, for example, is mulling easing the lockdown starting early June. In the meantime, no field collection exercise is possible. How should the operational processes in these emerging Asian markets adjust to address the changes then?

THE NEW NORMAL IN DEBT COLLECTION

This increase in NPLs combined with the urgency to improve collections has prompted financial institutions to use every tool available to update their current collection strategies, systems and to motivate their teams before more borrowers roll into the later delinquency buckets. Furthermore, collections teams face enormous pressure to do more with less. Consumer preferences, resources cuts, pressure to reduce costs and complex regulation, have all forced financial institutions to adopt new collection strategies, technology that allows them to be more efficient and react faster on the changed environment.

DEBT COLLECTION STRATEGY

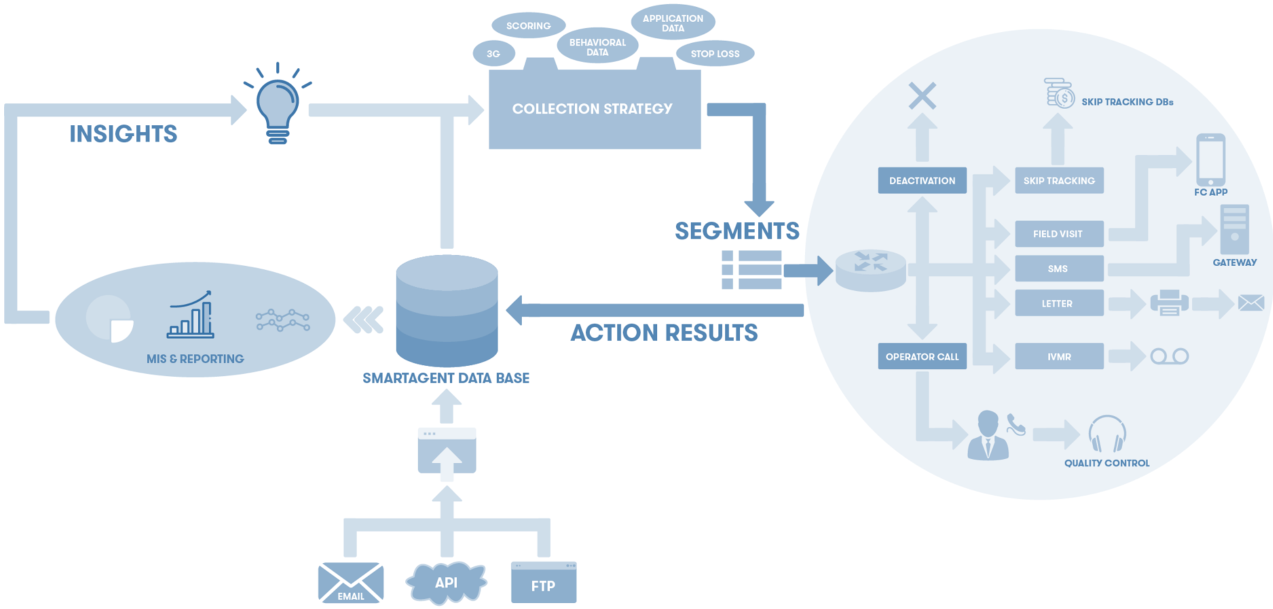

Figure 7 Outline of an efficient integrated collection strategies, system, and people. Source: In-house Operations team

Lenders need to implement sound collection strategies to improve decision-making and make recovery more efficient. The strategy should entail ethical standards, be well-controlled and incorporated into the tools and rules to enhance the contact process and appropriate engagement to borrowers in a way that boosts collections while preserving their loyalty. Some effective collection strategies include:

DEEP SEGMENTATION

A technology-based debt collection system enables better and faster redemption of loans. Machine learning, for example, helps to define more insights from the data available and enhance the decision-making with alternative data points. Segmentation of borrowers is crucial to succeed in increasing collections through targeted messaging and communication. With alternative data such as browsing history and devices, and geolocation, it is possible to further categorise borrower. This information gives lenders behavioural clues to borrowers' reaction toward contact treatments. Once the segmentation has been determined, collectors can determine the appropriate contact and treatment strategies.
Asian economies are among the hardest hit when global manufacturing and trade came to a standstill in the face of coronavirus. Consequently, most borrowers are under pressure to fulfill their

obligations to their lenders, who are also facing the problem of piling non-performing loans. Nevertheless, it is still necessary to determine the motivations behind the borrowers' inability to pay up as agreed. It is another instance where segmentation and targeted messaging proves helpful.

More importantly, segmentation also allows lenders to distinguish and identify borrowers who prefer to self-serve and respond to automated messaging with minimal contact as compared to borrowers who require human contact. This will allow call operators to use their time more effectively and maximise their capacity to tend to borrowers at higher delinquency risk.

TAILORING COMMUNICATION TO EACH SEGMENT

Segmentation allows lenders to tailor communication messages providing greater empathy, support, or even a partnership to borrowers. Lenders can pinpoint behaviours and determine the best time, channel, and frequency to contact using predictive analytics.
India, Indonesia, and Vietnam are emerging economies whose populations are still learning the vagaries of the credit industry. Therefore, collectors must segment them into smaller yet specific groups for better understanding.

Advanced analytics by AI and ML enables the segmentation of borrowers based on probability of payment. A borrower with a higher probability of repayment, for example, does not require an aggressive engagement strategy. When communicating with this segment, collectors might adopt a process where they use certain cues that evaluate the chances of breaking repayment promises and understanding the borrowers' situation and motivating them to pay by offering specific deals such as waivers, restructurings or credit vacations.

RE-IMAGINING THE CALL CENTRE

Having a call centre is essential for communication between the debt collectors and the borrowers. However, the usual call centre strategies may not work during a time like the present economic crisis where the share of contacting cases as well as the number of interactions per each contacting person will go down.

Hence, the quality of the negotiation matters more since the value of mistake now is tremendously high. Besides the standard knowledge improvement and retraining, we should consider enhancing call operators with routing calls based on psychological profiling to match people who naturally have higher chances to gain an agreement. Call scripts should also be adjusted based on psychological profile of the borrowers, same message can be delivered with different wordings which increases the chances of being heard and reaching mutual agreement more easily.

DEBT COLLECTION SYSTEM

After the collection strategy and collection business processes are better defined, lenders must seek adjustment to the debt collection system. Changes in system should support and enhance the changes in above mentioned areas.

ADOPT AUTOMATION OF JOBS

Manual debt collection is cumbersome and time-consuming. On the other hand, the automation of debt collection scales and broadens avenues for communication with the borrowers. As core of operational processes, automation will ensure quality control and accuracy in decision-making. Digital collection processes are also geared towards handling larger volumes with lesser manpower for greater scalability.

An operator's core focus is negotiation. The collection system should provide them with the right calls and in sufficient volume to ensure maximum utilisation. Automation of decision making such as daily assignment of borrowers to the different actions by the appropriate collection strategy and automation of campaign execution meaning human-free actions like dialing for agents. This increases the amount of work done and also ensures no human factor impacting the collection process.

Automation let you build factory by decomposing the whole operational process on micro homogeneous pieces, allows to standardise and automate them Besides, automated systems ensure that connection remains between a lender and borrower, eventually building trust between them, as compared to manual process where contact is not as frequent.

EXPAND COMMUNICATION CHANNELS & PROVIDE SELF-SERVICING OPTIONS

During an economic crisis, the distress levels on all sides of the debt divide are often insurmountable. The earlier lenders start expanding digital channels such as borrowers' portal and emails, and exposing borrowers to these different channels, the more continuous and fluid the process will be since it requires time to educate the borrowers and build a habit.

Providing borrowers self-service options to proactively resolve their issues simplifies the debt repayment. Features to include in self-servicing are online payment, status updates, activity history, promise-to pay, data exchange for payment disputes, and feedback loop from borrowers.

This gives borrowers a less distressing user experience since falling behind on loan payments can be a sensitive topic.

DEBT COLLECTION TEAM

On top of the improved collection process, to ensure consistency of the new approach, lenders also need to turn their focus on motivating their collection team especially the call operators who are often the ones in first contact with borrowers.

INCENTIVES FOR CALL OPERATORS

Customer satisfaction is a key goal for all collectors. A critical KPI to use to measure the effectiveness of call operators is to use the customer satisfaction score (CSAT). Lenders can use the CSAT to ask customers directly to rate their satisfaction with the way call operators handle the collection process. All the responses are tallied, and the average is the CSAT score for the call agent. The other KPI is employee engagement.

While call operators play a significant role in achieving the collection's goal, they also need to show satisfaction in their duties. It should not just be about the monetary motivation but also how they manage to support and empower borrowers to overcome financial difficulties. Therefore, it is imperative to ensure that the call operators are well-motivated to avoid a high turnover rate.

DEVELOPMENT OF EMOTIONAL INTELLIGENCE

Debt collection is emotionally draining. Being among frontline employees, the emotional intelligence of call operators needs to be developed appropriately. Emotional intelligence (EI) is the ability to call operators to manage their emotions and those of the individuals they call. As we have seen already, debt delinquency increases during economic crises. Therefore, intelligent skills-based routing need to be deployed, having a borrower connect with the operator most-suited to solving their problem improves the borrower's experience and increase the chances of recovery by speaking the same language and showing empathy to the borrower.

Call operators dealing with distressed borrowers need careful handling. Developing the emotional intelligence of call operators is crucial for collectors that desire to improve collections.

DIGITAL TRANSFORMATION

At the heart of upgrading debt collection system and redefining strategies lies digital transformation of the traditional collection process. With social-distancing measures in place, lenders need to invest immediately in shifting towards a digital-first collections model as field collection will become more and more obsolete.

In emerging Asian markets, debt collection is mainly manual. Additionally, the physical nature of debt collection in countries such as India, Vietnam, and Indonesia mean that collection agents often engage in hostile actions. In a sense, this beleaguers the borrowers, which might lead to an increase in default rates.

Digital transformation is a necessity for financial institutions looking to reduce borrower handling time, simplify debt collection as well as meet regulatory requirements to minimise legal action and penalties. These powerful digital innovations are transforming collections operations. When done well, financial institutions can improve outcomes and performance at a lower cost, gain better criteria for segmentation and more effective contact strategies and identify probable defaulters. This improved understanding allows them to apply data-driven strategies to improve collections, borrowers' experiences and even empowering some borrowers to gain a greater control over their finances.

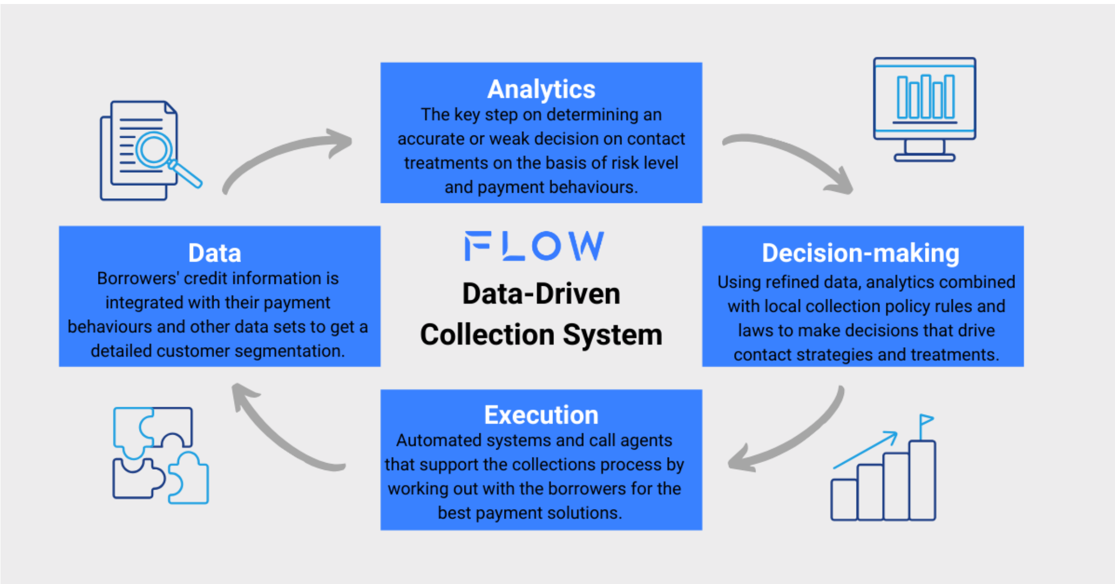

Figure 8 A complete, functioning data-driven collection system for better debt recovery. Source: In-house Operations team.

WHEN SHOULD LENDERS OUTSOURCE?

During financial crises and their aftermath, lenders face numerous challenges, key among them are non-performing loans. For lenders in emerging Asian markets, tackling non-performing loans (NPLs) is even more daunting because of strategies and systems that are slow to adapt to the present. Lenders need to evaluate their in-house collection capacity at multiple angles ranging from their collection system to processes to level of technology presently integrated into these and should certainly assess when to collect on a debt directly, get third party collection agency, or sell a debt at its maximum value.

Engaging third parties with specialised skills that the financial institutions do not have a strong edge on will scale recovery process greatly. A sophisticated data infrastructure is important for debt collection, but there are several obstacles preventing financial institutions from investing in one. Skill gaps and cleaning data are just some of the challenges obstructing them. Furthermore, institutions need to set a data strategy and implement the right models, which is time-consuming, and institutions must be cautious about allocating resources for long-term projects.

Fresher debt cases usually from the first three buckets are traditionally handled in-house and then, effectively incorporate third parties with strong technology and collection capabilities to strengthen collections performance for more unique or complicated cases. Efficiency is affected by the in-house's collection methods. Collectors need to manage on their internal resources and preserve their reserves prudently.

The earlier debt is collected, the more healthy NPL ratios will be with less delinquency rolling to next buckets. Lenders always have their hands full, especially during an economic crisis, with an increased number of loan delinquency and ensuring that they stay afloat. This kind of juggling undermines their collection efforts, which might expose them to a bigger existential threat.

At critical time, financial institutions need to know where to allocate resources and focus on what brings best revenue and operational efficiency. The rate of success depends on how well lenders focus more on efficiency, scaling up capacity of collection process. Operational efficiency should remain the top-most priority for lenders. They must keep the loyalty of the customer but also collect enough of their accounts to remain afloat. A rebooting economy may need to work around social distancing, increased sensitivity to security, and heightened risk awareness. Lenders need to adjust to these changes to maximise their recoveries.

ABOUT FLOW & OUR METHODOLOGY

Founded in 2016, Flow is a credit management company that is transforming the business of unsecured consumer finance through AI technologies and ethical practices in the APAC region. One-size-fits-all approach of traditional debt collection is limiting for both lenders and borrowers.

Redefining debt collection begins with creating personalised, digital-first experiences that help consumers overcome their financial difficulties. Flow's data-driven collection strategies have proven remarkable recovery rates for top financial institutions and have supported over 2.8 million consumers to date. Headquartered in Singapore, the company launched in Vietnam and has since expanded to Indonesia and India.

For this whitepaper, data used for analysis are derived from in-house Risk and Operations teams, desk research and in-depth discussions with retail loan focused debt collection management executives from leading financial institutions in Asia. Multiple surveys and interviews were conducted to understand the current and planned actions of partners and the extent to which the trends of debt collection are expected to change over this course of the economic crisis.

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