Using Purchase & Payment Behavior Data to Mitigate and Evaluate Risk

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Abstract

Behavioral data provides a wealth of knowledge for credit managers and financial executives. The most robust data is acquired by pooling information from different areas of business, ensuring a broader and more accurate overview of their customers, suppliers, and prospects. This includes bifurcating data pools to understand payment patterns and spend analysis for robust and in-depth decisioning.

You wouldn't rely on yesterday's news as a source of information on today's events, would you? So why rely on yesterday's credit data to make future business credit decisions? For decades, businesses have relied solely on the payment history and generic credit score of a company in order to determine credit worthiness for new and existing customers. The reality is that technology is moving fast, providing financial professionals with new resources and tools to use throughout the decision making process. The B2B credit world is long overdue in borrowing a page from the innovators in business-to-consumer analytics. That's where the analysis of behavioral data comes in. Combined with traditional payment data, purchase behavior data and spending trends are taking the industry by storm, providing brand new and more robust insight about what's going on with businesses internally. Credit professionals are finding this to be a powerful source of information, increasing visibility into the credit worthiness of both public and private businesses.

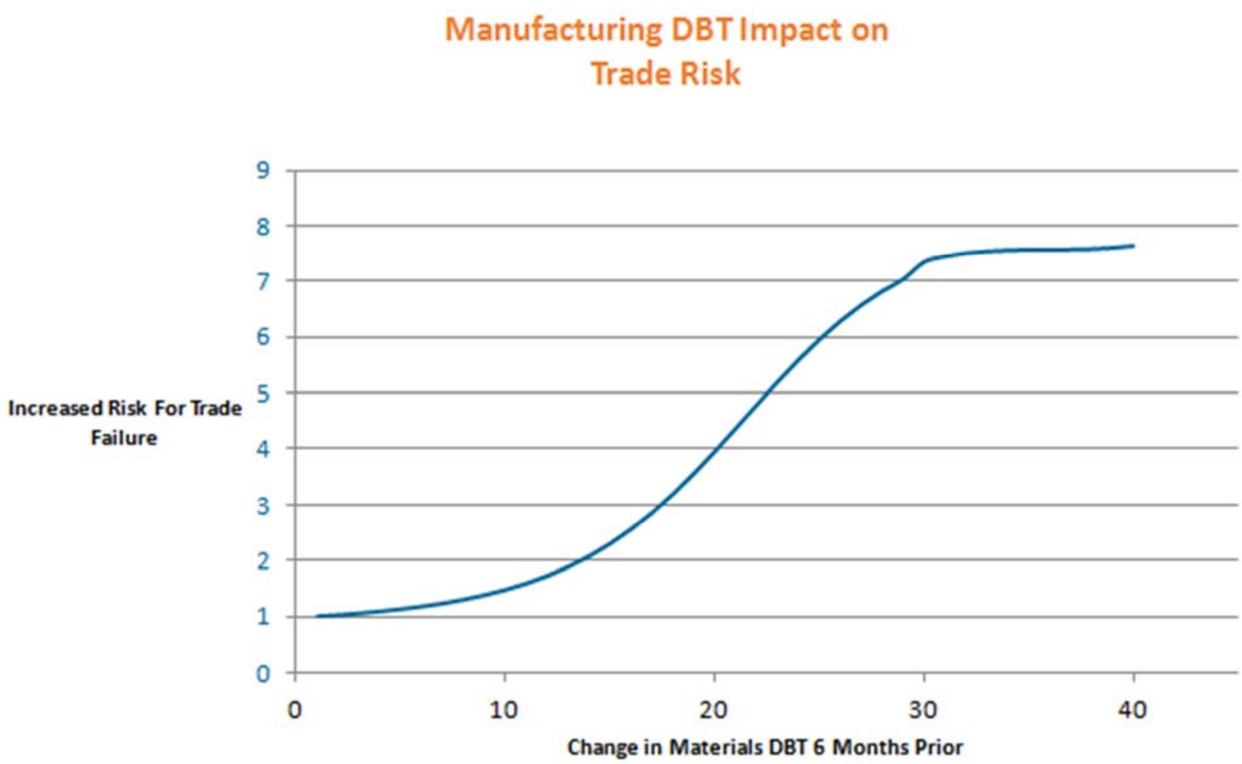
Of course, traditional payment data will always hold its place in the market for risk mitigation and evaluation. But take a look around; technology is advancing, medicine is advancing, even the education system is changing. So why does the B2B credit information industry seem to be stuck at a standstill? In order to make more well-informed decisions, increase revenue and avoid potential risk, credit managers and other finance professionals need to take a deeper look into what's really going on beneath the surface.

Ever since the broad adoption of credit and debit cards, retailers have employed increasingly sophisticated methods for capturing and analyzing consumer purchase and industry-specific payment habits. Through data mining, pattern detection, market basket analysis and other techniques, they have dramatically improved their ability to identify premium customers, assess future risks, improve cross-selling opportunities, predict future purchasing behavior and enhance credit decisions. Consumers are either granted or denied a certain credit, often at varying interest rates, based not only on how quickly they pay, but on how and what they buy. Technology and Data providers allow you to incorporate this data into your own models to determine the threshold of credit you want to extend to customers based on past experiences.

Banks and major retailers have been able to identify the best customers and avoid the riskiest ones. Now imagine the same advantage in the B2B world. As with consumers, the manner in which companies spend their money speaks volumes about their priorities and direction. Such data simply hasn't been available until now, which is what makes now such an exciting time for the B2B credit industry. As the demands of risk mitigation experts increase, practices need to evolve in order to keep up. Credit departments are being asked to do more with less; that's more responsibilities with less time to spend on evaluating information. As an example of the power of incorporating purchase and payment data into credit processes, a leading provider's customer with an internal statistics model for predicting defaults improved the predictiveness of the model by 24%. This improves their up-front credit decision making and provides them with earlier warning to increasing credit risk in their customer portfolio. With the new data that behavioral analysis provides, the industry can move towards less risky business ventures based on intelligent, predictive, information-based decisions.

Getting the Most of Behavioral Data

Behavioral data provides a wealth of knowledge for credit managers and financial executives, even sales professionals and marketing departments, to use in their business practices. The most robust data is acquired by pooling information from different areas of business, ensuring a broader and more accurate overview of their customers, suppliers, and prospects. This includes payment behavior, purchase behavior, spend across industries, hiring and layoffs, adding new locations, expanding, downsizing, and more. Once the data is available, it can be categorized and segmented in order to identify relationships amongst different industries and areas of business. Analyzing the spend in each category is key. The information found in spend analysis, combined with traditional data, serves as a strong evaluation of a company's overall financial health. It indicates whether they are growing, downsizing, or just maintaining steady business. The insight that this data provides allows credit managers to take action that can either drive revenue or avoid potential risk. Just like with consumers, a business who is spending more but paying slower is considered a higher risk. But what makes businesses different from consumers is that they still need to spend in order to grow. What that means for credit professionals is that a company who is still paying on time but has slowed spending is often just as risky as the latter. By leveraging a broad network of diverse companies, credit managers are also able to use this purchase data as a predictive indicator for how a company might behave in the future. For instance, on average, when a manufacturing company has its materials payments slow down by roughly 30 days over the course of the year, they are likely to be at significantly higher risk for a trade credit failure within a matter of 6 months (see below chart). This is just one scenario where we are able to use specific attributes of companies that have gone into default or filed for bankruptcy, and what indicators may have brought them there.



This graph is showing the changes in payment speed for a Manufacturing company to its Materials providers and how that correlates to their risk for trade failure. So a Manufacturing company who started paying its Materials providers 30 days more slowly over a 6 month period is 8 times more likely to have severe trade delinquency problems compared to a company who is consistently paying their Materials providers.

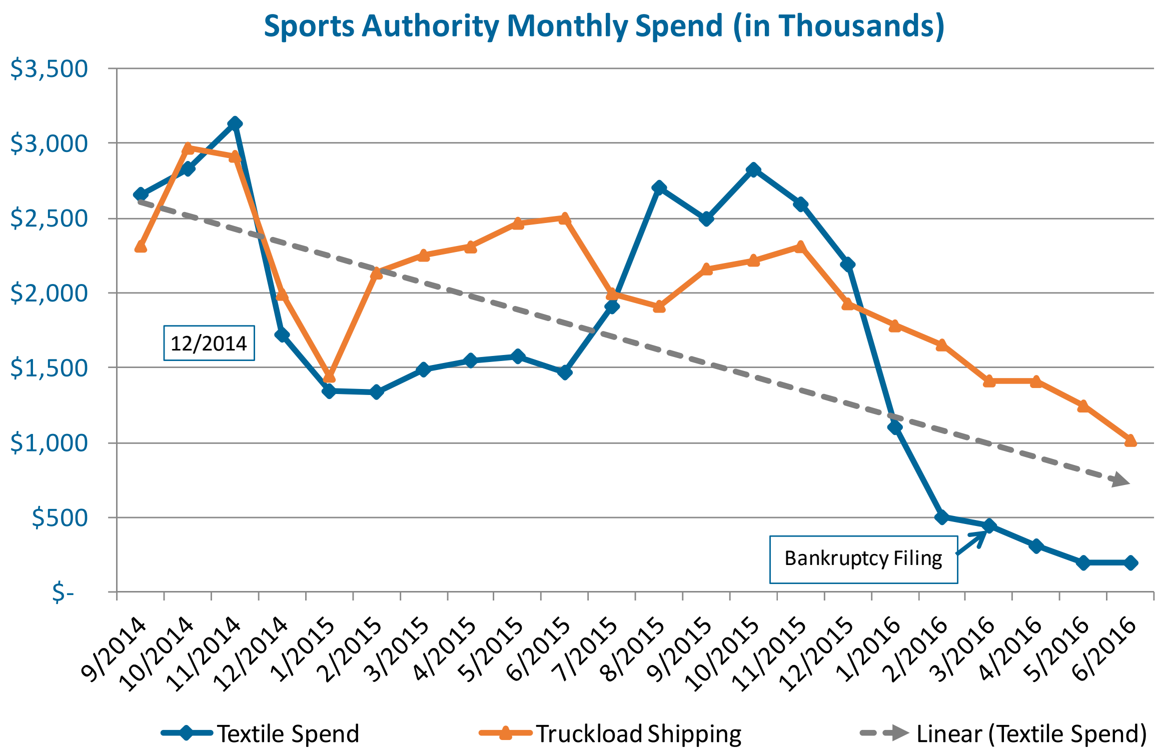
Understanding the Importance of Purchase Behavior

There's more to a company's credit-worthiness than just timely payments. Payment data and purchase behavior provides insight into a company's priorities.

By evaluating how companies tend to pay certain types of providers, it can determine how important they consider each of these types of providers. Overall, Insurance companies are the most likely to get paid, and get paid on time at a 90% on time payment rate. *When a company stops paying their insurance provider, this may be a strong indication that the business is in trouble.* Fuel companies and Oil & Gas companies are also highly likely to get paid by businesses, even in times of distress, whereas Legal Services companies are the least likely to get paid indicating this is a higher risk industry to operate in.

When broken down by industry, a connection can be drawn as to whether sales are likely growing or declining. If a company's monthly balance with their key suppliers is continuously growing, this would indicate that their business is trending upward. In this case you may want to consider extending their credit limit or taking advantage of additional sales opportunities. On the flip side, if a company is showing decreasing monthly balances with their key suppliers, this may indicate that business is taking a downturn. This insight allows the credit professional to make the well-informed decision and take a much more cautious route in extending credit until such time as they show signs of recovery. In the long run, this may deter you from extending trade to a company who will soon file for bankruptcy or close its doors.

Let's put this into perspective; Sports Authority recently filed for bankruptcy in March 2016. Leading up to this filing, Sports Authority's DBT was consistently in line with industry benchmarks and their credit risk score was moderately strong. On the surface, they seemed to be doing well - operating business as usual. However, if we take a deeper look into their spending trends, we could have been alerted to their troubles months in advance. Depending on the industry a company operates in, certain spend data can be more telling than others. If we look at Textile spend and Truckload Shipping spend for Sports Authority, we can see that this purchase behavior started to dramatically decrease as early as December 2014, 16 months prior to their bankruptcy filing. Truckload shipping dropped more than 30% from the prior month in December 2014 and Textile spend dropped 18%. This insight into their spend behavior allowed credit professionals to see that business could be on the decline, so they were not surprised when news of a Chapter 11 was announced. Vendors were able to tighten credit limits, adjust payment terms, or keep a closer watch on them based on these spending trends. Becoming aware of these red flags early on gives decision makers the opportunity to act in an effort to protect themselves before it is too late.



<u>Use Leading Rather Than Trailing Indicators to Reduce Risk</u>

On its own, a business's credit rating does not identify potential risk of revenue loss. Traditional data for risk decision is based largely on payment behavior. That can be useful, but it's also normally a lagging indicator. Behavior-based insights provide a wealth of indicating factors that can predict future behavior and potential risk. This data, which is rapidly becoming a highly-valuable corporate asset and overall industry game-changer, helps alert to increasing risk within a failing company before it is too late. Declines in materials spend, drops in materials purchases, and decreases in shipping expenditures may illustrate that a company is becoming less financially stable. Credit professionals who use these insights are able to make more educated decisions beyond what is available from a generic payment score.

Like many positions within today's organizations, the role of credit managers and financial executives is evolving. There's a deeper emphasis on providing other departments, such as sales, with information to help them improve their pipelines and close deals. Leveraging deeper insights from customers' purchase and industry-specific payment behavior data allows credit and risk professionals to better manage risk and uncover growth opportunities. As a leading indicator, purchase behavior data can reveal hidden financial strengths or detect troublesome financial trends months before they appear in traditional credit and payment reports. By combining payment and purchase behavior data, credit departments can more rapidly and confidently identify your most valuable customers and prospects, accelerating the credit processes and increasing monthly cash flow.

Up-selling to Customers Who Have a High Propensity to Buy

It's important to mention that the use of behavioral data cannot only protect your business from getting burned, but can also work in favor of sales as a driving force behind new revenue. One of the first steps in selling more is seeing more. If you want to increase revenue, you've got to be able to identify the right opportunities. Purchase behavior data serves as a real-time reference point to the areas where a company is increasing spend. By analyzing the data, businesses can identify upward trends and predictable growth opportunities before making another sales call. A key component of trade data is a company's purchase behavior, which delineates whether or not a company is growing (increasing spend on shipping & manufacturing for example) or struggling (decreasing spending on or completely aborting operations, as another example).

Has a company increased their spend in transportation recently? How about a sudden increase in business services, perhaps signaling the opening of a new plant/office? Communicating this information with your sales team empowers you as a key sales resource and growth driver, and allows you to either increase credit limits and pre-approve, or monitor any potential risk with a more advanced warning.

The details and trends revealed in your customers' spending habits will help you to determine whether that company is growing and may be interested in new products or services, or failing, meaning that their business may be struggling. Based on that new insight, you can make a well-informed decision about how best to implement a new sales strategy. Statistically, an existing customer is 45% more profitable than a brand new one. An established business relationship provides ripe up-sell opportunities, which often carry a higher sales value than an initial contract. Actively monitoring the business behavior of your existing customers can increase retention rates and revenue growth. With purchase and payment behavior details on a wide range of businesses, you can more thoroughly profile each customer. You'll have the means to accurately gauge your current and potential wallet share with each specific customer.

Accelerating the New Customer On-boarding Process

In addition to up-selling your current customers, the incorporation of purchase and industry-specific payment behavior enables credit departments to set credit limits for new customers with more speed and confidence. Instead of basing this decision largely on a payment score, you're now able to take into consideration where a business is spending their top dollar and how companies like you are getting paid. For instance, imagine that you are a materials company who is considering working with a particular business. That business's top balances are with materials providers, averaging $5 million and consistently paying those suppliers within one day of the set terms. That same business's lowest balances are with transportation suppliers, of which they pay 10 days late. In this scenario, which piece of information is more valuable to you? The behavioral trends seen with suppliers in the materials industry are more applicable and relevant to the decision that you would need to make here. By taking a deeper look into your specific industry, you see that this company may deserve a higher credit limit and more flexible terms than what their overall payment score implied. If you're a transportation supplier to the same business, you can expect to get paid more slowly that their materials providers. As we've all experienced, often painfully, not all suppliers to companies get treated the same.

Utilizing the deeper-rooted details of behavioral analysis allows you to more efficiently protect your company from risk without slowing the sales process. At the end of the day, you're protecting your business with better information, and essentially bypassing some of the time-consuming, manual research that would need to be done if you were using an outdated reporting system or mining this information in-house. In essence, this knowledge gives you the power to save time, which saves you money, letting you get back to everything else you need to do.

Now That We Have This New Information, What's Next?

As this network of information continues to grow and expand, more accurate, easy to understand products and services will become available for businesses to take advantage of when evaluating potential risk. User-friendly credit reporting and monitoring systems are essential to the financial futures of today's quickly moving businesses. Getting burned by a customer suddenly closing its doors will be less of a possibility, as risk mitigation experts have more complete, accurate and insightful information available to them. The best part is that purchase and industry-specific payment behavior data doesn't have to complicate or lengthen this process. It supplements straightforward, simple, and user-friendly tools that make a heavy workload easier to manage. Today's credit departments need useful, insightful, and accurate information. Better data leads to better solutions, providing new and more in-depth business insights. Many of the important questions are being answered, such as how your customers pay others in your industry. Knowing that your customers value your business differently than your competitors gives you useful insight as to how you are perceived. Using this information allows you to uncover some important factors in improving or cleaning up certain aspects of your business practices, aside from simply making a decision on how much credit and what terms to offer. Where in the hierarchy of your customer's payment priorities does your company fit across all of their vendors? What your customers are purchasing and who they pay the fastest tells you about where you are in the risk cycle, as well as what is most crucial to their survival. Is your customer's spending on freight changing, and are they purchasing manufacturing materials at a different rate? Again, outside of monitoring your receivables, are you noticing behavior changes that you can use to your advantage either to extend credit and terms as you perceive growth or to tighten the reigns as you recognize indicators that point to possible financial distress? The new "live" model of trade data will continue to improve the previous practices of relying heavily on general payment trends to mitigate and evaluate risk.

Purchase behavior data is a revolutionary element that has been missing from the B2B credit reporting and business information world. If you're not already leveraging purchase and industry-specific payment insights in your credit decisioning and monitoring processes, you may be missing out on powerful new tools.

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