EBOOK

Take Control of Portfolio Risk Management

Data-Driven Strategies for Balancing Risk and Growth

Change and Risk Are Constant

It's an ongoing challenge for credit managers to manage the risk appetite of their companies.

Market conditions are constantly changing, impacting valuations and risk exposure. Credit managers face pressure to understand and reduce risk and automate their processes. Teams also are increasingly being measured on growth, which brings yet another lens and challenge to their portfolio risk management remit.

This means credit managers need reliable access to as complete a view of their customers as possible.

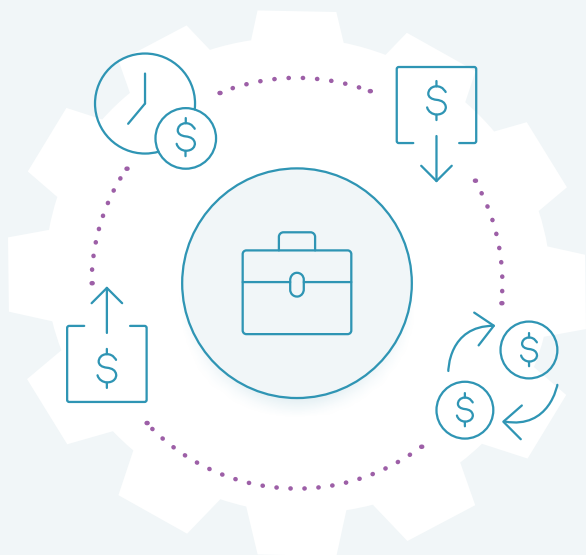# Set the Stage with a Portfolio Assessment

Before taking any portfolio risk management actions, credit managers can benefit from taking stock of the portfolio's performance.

What is the risk profile? How does that compare to the industry standards? What else can be learned about these customers? These questions can be addressed via basic analyses. Common approaches include segmentation analyses or use of a "sandbox" environment.

By reviewing the findings in the context of the overall business performance and goals, credit teams are able to more effectively prioritize data-driven strategies to balance risk and growth. This background also helps set filters and thresholds for the various metrics and triggers leveraged in these strategies.

ACTIVITY-BASED STRATEGIES

EVENT-BASED STRATEGIES

A Two-Pronged Approach to Balance Broad Coverage and Focused Action

Credit managers can benefit from implementing a combination of two complementary data-driven approaches. The first approach involves applying ongoing management initiatives to the full portfolio; we'll refer to these as "ACTIVITY-BASED" strategies.

The second approach consists of monitoring the highest-risk accounts through alert triggers. Since this approach relies on monitoring signals that a potentially actionable change has occurred, we'll refer to these as "EVENT-BASED" strategies.

Let's start with four activity-based strategies that can be part of a credit manager's tasks for the full portfolio, along with data and tools that were designed to support them. Note that the right data and models built on these datasets can help automate these efforts.

Credit Line Increases

For accounts whose payment behaviors exceed expectations or when their scores (whether from internal or external models) predict desirable behavior, credit teams can promote business growth by increasing credit limits. This can be particularly appealing if off-self credit utilization (e.g., with competitors) is stronger than on-self utilization.

To avoid increasing portfolio risk beyond acceptable levels, credit managers can consider tactics such as setting a maximum size of increase and/or a maximum new limit. Think about using this approach with limited frequency in order to allow time to assess changes in behaviors after each increase.

Credit Line Decreases

Conversely, when behavioral data and/or scores deteriorate to a level that indicates potential future charge-offs, credit teams may want to consider reducing risk by decreasing credit limits. In such cases, credit managers may decide to decrease credit lines to the current balances. If the limit decrease is expected to be delayed, one option is to remove open-to-buy by setting it to zero.

Off-self behavioral data, including non-financial credit, can be particularly insightful, as many businesses choose to prioritize paying their financial obligations over smaller trade credit accounts in order to protect their cash flow.

ACTIVITY-BASED STRATEGY #3

Collections

While many enterprises keep credit and collections separate, the two departments can work together to weigh their portfolio risk management decisions to extend credit to customers that are most likely to pay in a delinquent manner. When a customer fails to make payments, the credit team's specific activities often vary by stage of delinquency.

Early-Stage Delinquency

TYPICALLY 30 OR 60 DAYS PAST DUE

Early-stage delinquencies are typically handled internally via letters, calls, emails, and text messages, with the more labor-intensive contacts (letters and calls) managed via a collections queue.

The queue can be prioritized based on the risk of reaching late-stage delinquency, which is known as a probability of default model. Since the low-risk population (typically the 25% lowest risk) may have paid late as a result of an oversight, these tend to self-cure, so collection efforts on these accounts can be delayed. At this stage, some credit managers may opt to apply a credit hold.

For the remaining delinquent accounts, the type and cadence of contacts can be set based on user preferences and behaviors, along with historical success rates.

Late-Stage Delinquency

BEYOND 60+ DAYS PAST DUE

After 60 days past due, the collections queue may be prioritized based on the balance and past-due age, along with the dollars likely to be collected, or a loss given default collection model. If they did not already do it earlier in the process, enterprises can minimize risk by placing a credit hold on the account.

In many cases, enterprises may opt to work with a third-party collection agency, which may handle all or just the highest-impact accounts, based on balance and/or dollars likely to be collected. Either way, finance teams generally weigh the cost of collecting to help them decide whether to continue collection efforts, offer to settle with a lowered balance, or consider legal action.

Post-Charge-Offs

When a delinquent account ages beyond 120 days, the likelihood of getting paid decreases significantly. Enterprises again can consider their options before writing off the account as bad debt.

They may enlist outside help from a third-party collection agency. Companies may also choose to limit losses by selling the debt to a debt buyer, which can then initiate its own collection efforts.
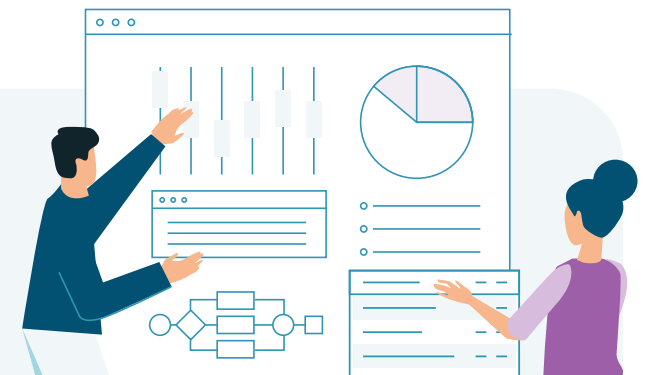
Data-Centric Best Practices

All the approaches listed in this portfolio risk management guide rely on comprehensive, up-to-date data and analytics, and so it follows that hygiene steps are critical to performance.

Most enterprises know the value of third-party data and understand that fresher attributes and scores usually are more useful.

To ensure the most current data is considered, businesses can opt for API-driven solutions that continuously update values as they're needed. In the absence of that, for companies that still use flat files in their systems, a monthly or quarterly refresh schedule for the full files may be an option.

Likewise, since business identity attributes (name, location, ownership) also change, periodically rematching the portfolio can be a crucial step. Some organizations choose a quarterly cadence, but for others an annual rematch can be adequate.

Beyond systematic updates as outlined above, data should be assessed periodically. As with many data stewardship efforts, credit teams often focus on the highest-impact records. In practice, this can translate to focusing validation sweeps by data stewards on the top accounts by exposure risk. Common approaches can include selecting the top 20% by risk and/or establishing a minimum threshold for the exposed dollars, either in terms of balance or credit line.

Trigger/Event-Based Strategies for High-Risk Segments

The second approach to portfolio management focuses on event-based triggers. Since these strategies can be costly in terms of labor, specialized services, and computing power, credit managers may decide to apply them only to the highest-exposure accounts. This exposure assessment typically combines risk scores, activity, and balance.

To be clear, these accounts are still included in the full-portfolio risk management activities covered by the first approach — the activity-based strategies. What event-based triggers bring is the ability to receive alerts on a frequent basis so that portfolio managers can react in near-real time to help minimize loss.

EVENT-BASED STRATEGY #1

Utilize External Data Sources to Push Alert Triggers

Monitoring services can provide push alerts on a set portfolio. These alerts can be configured to be delivered on whatever frequency suits the business's needs and its ability to ingest and act upon them. This frequency can be monthly, weekly, daily, or even intradaily.

Another key part of the configuration is the criteria based on key variables — typically those used on the risk models discussed earlier in this guide. Criteria can be either absolute (i.e., if a score rises above or dips below a set critical value) or relative (i.e., a point or percentage difference).

In both cases, these thresholds need to help indicate a significant negative change in the business's underlying state. For example, a 1-point drop in a business credit score likely isn't worth initiating mitigation workflows. A 20% drop — or a bankruptcy filing or lawsuit — is more likely to reflect a true change in the company's ability to meet its financial obligations.

Focus on the Highest-Risk Accounts

Since most portfolio risk management teams have limited resources, they try to generate actionable alerts, which often focus trigger efforts on the highest-risk 2% to 5% of accounts. The initial selection of accounts to monitor generally is determined by exposure (line and balance dollars) and risk assessments (from the full-portfolio risk models).

Once a high-risk segment is identified, triggers can be generated based on a number of events, such as:

- External delinquency or charge-off with another company
- High-dollar suits, liens, or judgments
- Excessive new credit/exposure opened
- Rising revolving credit utilization
- Reduced payment-to-balance ratio

Strive for High Actionability

Alerts are useful if they help enable finance teams to prevent losses through concrete actions such as credit limit decreases, credit holds, and accelerated collections.

When is the "right" balance between capturing predicted delinquencies and minimizing manual reviews achieved? Some practitioners define this as when roughly 20% of alerts result in an adverse action. If the action rate is significantly different, credit managers may revise criteria and/or the review process.

Further, credit teams may also revise the criteria used to identify the highest-risk 2%–5% of accounts for proper portfolio risk management. While this is typically covered during model validation and recalibration efforts as noted above, a finding that adverse actions are markedly different from expected may suggest that a model tune-up might be needed.

Benefits for You and Your Business

A dynamic economic environment can increase the complexity of portfolio risk management. But credit managers can take control with a combination of powerful data and these fundamental strategies to help organize and streamline their efforts. The result can be more effective portfolio risk management that positively impacts cash flow, profitability, sustainability, and healthy business growth.

Learn more about how Dun & Bradstreet can help credit, collections, and finance teams.

Explore our resources focused on improving accounts receivable management, minimizing losses, and protecting revenue.

ABOUT DUN & BRADSTREET®

Dun & Bradstreet, a leading global provider of B2B data, insights and AI-driven platforms, helps organizations around the world grow and thrive. Dun & Bradstreet's Data Cloud fuels solutions and delivers insights that empower customers to grow revenue, increase margins, manage risk, and help stay compliant — even in changing times. Since 1841, companies of every size have relied on Dun & Bradstreet. Dun & Bradstreet is publicly traded on the New York Stock Exchange (NYSE: DNB). Twitter: @DunBradstreet

dnb.com