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Transforming Debt Management in Finance: Harnessing AI for Collections

Catalysing lending transformation: leveraging AI innovation to navigate shifting customer behaviors and overcome collections challenges

White Paper

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Executive Summary

The financial sector faces numerous challenges, with extensive competition driving down net interest income and commissions and the disruption caused by new banks and lenders such as Google, Apple, Facebook and Amazon (GAFA) threatening the very existence of traditional banks.

These factors, combined with the calling for on-demand services from consumers and the emergence of cloud-based technology and artificial intelligence (AI), are creating an "adapt or die" ultimatum for financial organisations. Now is the time to be more dynamic, cost-effective, diversified and innovative.

One of the most overlooked elements within the financial sector is the importance of efficient debt collection processes and the potential to optimise scoring with that data

One of the most overlooked elements within the financial sector is the importance of efficient debt collection processes and the potential to optimise scoring with transaction data. While most banks and financial organisations have deployed some sort of proprietary or rented in-house software or have collaborated with a third-party collection agency, very few have started leveraging the technological potential of AI and advanced machine learning (ML).

Those who embrace the evolution of the global credit environment now and use innovative technology-led collection processes stand to gain richer insights into their customers' behaviour while benefiting from a competitive edge in the market by operationalising the valuable data gathered before inevitable mass adoption begins.

However, like most technology and innovation in the financial sector, change takes time. A prime example of this is contactless payments, which Mobil gas stations trialled with their Speedpass in 1997. The financial sector didn't utilise this technology for another two decades. Similarly, mobile payments were also piloted in 1997, while Coca-Cola introduced a limited number of vending machines where customers could make mobile purchases at that time. But financial organisations took decades to integrate this technology into their mobile banking services.

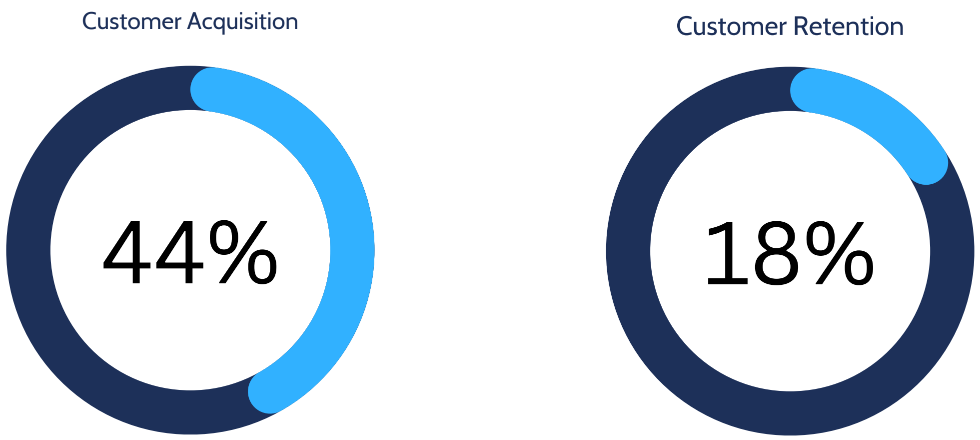
Mass adoption of collections technology powered by ML and AI is set to follow the same lengthy process for the diffusion of innovation outlined by Everett Rogers. The concept will require knowledge sharing, persuasion, implementation, confirmation and decision-making before key figures take action.

Table of Contents

The current collections landscape

Why simple automation of collection processes isn't enough and is losing retail banks valuable customers

According to Invesp, it costs five times as much to acquire new customers than to keep an existing one. But the current attitude towards collections is to do anything possible to get customers to settle their debts and get them off the company books. In fact, the same report from Invesp shows that 44% of companies place a greater focus on customer acquisition versus 18% who focus on retention.



44 % of companies have a greater focus on customer acquisition vs. 18% that focus on retention

It's a worrying trend that is costing banks and other businesses millions of Euros in marketing and sales costs every year. This approach would not be an issue if every customer with an outstanding debt was deemed as bad or high-risk. However, this isn't the case. Every customer has a story and is facing different challenges.

The modern world has the luxury of choice and options. Customers no longer feel obliged or committed to staying loyal to one bank, thanks to low switching costs and the accessibility presented via the emergence of digital banking solutions and neo-banks in recent years.

Younger, computer-savvy millennials and Gen-Z customers come with increasing expectations of on-demand solutions. The notion of customers consistently taking calls and visiting branches during work hours is out of date. Making payments, especially when it involves something as negatively perceived as loans, credit or overdrafts, needs to be quick and simple.

Customers are calling for a seamless self-service solution accompanied by positive touchpoints along the way. Digitalisation is already commonplace in banks with online banking and on-demand apps, yet the adoption of digital solutions within collections operations isn't moving in lockstep with the rate of change across other departments. Banks haven't prioritised overhauling their collections processes and are still heavily relying on letters and calls instead of modern forms of communication like emails, text messages and push notifications, despite customers preferring the latter.

Exhibit 2

Credit-card customers mostly prefer to be contacted by email & text

Preferred channels of contact, ranked by % of respondents[1]

[1] N = 434 survey respondents. Analysis excludes respondents under 30 days delinquent
[2] Balance criteria: low <= $1,000, high >$1,000
[3] Risk criteria: low, FICO > 620; high, FICO < 620

https://www.mckinsey.com/business-functions/risk/our-insights/the-customer-mandate-to-digitize-collections-strategies

McKinsey & Company

Innovative solutions

In terms of tone, collections should be treated as a form of communication and not an imposition of terms. It's a matter of developing a dialogue and providing solutions that are personalised to suit a customer's unique story.

Customers have a psychological need for agency and autonomy. While the concept can be found in slight variations in many different domains, the general concept revolves around a human's need to feel in control. McKinsey's Guide on behavioural insights and innovative approaches in collections explores a common challenge where customers with overdue payments often avoid speaking to collectors by leveraging caller ID. Surprisingly, these customers express an intention to make payments promptly once they have the necessary funds. However, persistent and repetitive contacts from collectors create a sense of helplessness, making customers feel coerced into making payments against their will.

Customers are more likely to respond if they have access to a self-service solution led by a series of nudges

This phenomenon, known as "reactance" in psychology, often prompts customers to assert control by withholding payments or ignoring collectors.

According to studies cited in the aforementioned McKinsey report, approximately 20% of respondents admitted to intentionally withholding a planned payment following a distressing call from a collector. In contrast, a significant majority of 80% delayed making payments until they received a firm reminder.

Further, customer response rates are significantly higher when they are contacted through digital channels or have access to self-service solutions that employ a series of 'nudges'. Nudges refer to the practice of guiding behaviours through a user interface and design elements in digital environments. Scientific studies consistently demonstrate that, when considering costs, nudges tend to be more effective than traditional approaches.

Nudges take various forms and play a vital role in optimising the messaging of digital communication methods such as emails and SMS. In the realm of banking collections, notable examples include the implementation of both carrot and stick methods. This system involves banks offering incentives like early payment discounts, fee waivers, or flexible payment plans as a proactive approach, before resorting to warnings, administrative penalties, or legal action.

Banks frequently overlook the opportunity to proactively communicate with customers before they enter the late payment cycle. While reactive measures are typically well-established, the effectiveness of proactive approaches is often disregarded. By sending warm and friendly payment reminders weeks in advance, banks can ensure sufficient funds are available in customer accounts while alleviating stress on the collections team."

One area where banks tend to fall short is their reluctance to initiate communication prior to customers entering the late payment cycle. While reactive measures are in place, the potential of proactive strategies often goes untapped. By sending friendly payment reminders well in advance, banks can secure adequate account coverage and simultaneously alleviate pressure on the collections team."

Additionally, a report by the Association of Credit and Collection Professionals found that businesses that use a variety of dunning strategies, including email, phone, and mail, were more likely to recover their debts than businesses that relied on a single communication channel. The report found that using a combination of communication channels increased the likelihood of debt recovery by 30-40%.

Boosting recoveries and streamlining operations for Pactum Collections

Collections Efficiency

15.1%

increase in cash collection

Operational Improvements

68%

decrease in outbound calls

Digital Collections

15.6%

of payments made via landing pages

Monies Returned

9.1%

increase in 7-DPD customers' payback

Better Borrowing

200%

increase payment instalment plans

*All numbers in this case study are derived from comparing six-month-averages before and after implementing receeeve in Germany

New opportunities for lenders

How improved collections can help banks save money and achieve further growth

As discussed in the Executive Summary, various collection solutions are being presented to banks. However, most of them focus on workflow automation instead of self-optimising for time and conversion using AI and driving a resolutive dialogue with the customer.

There's an opportunity to leverage advanced technology to analyse and utilise existing data. AI can attain vital demographic and behavioural data and use it to craft the right message, send the message at the right time and know what channel to use.

Centralising data access and consolidating systems also serves to improve data hygiene and creates a uniform view of debtor profiles and portfolios more generally. By tailoring message content and approach, customers can be approached in a personalised way via their preferred channel, at a time they want, and using a nudge that resonates.

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Advanced analytics allow for a very nuanced breakdown of content performance and give banks an insight into which content performs best for a particular demographic. Pairing this knowledge with modern digital marketing KPIs can significantly help enhance operations. As Deloitte highlights in its white paper on 'Collections strategies for the digital age', using the right analytics, and doing it well, can enable banks to understand which customers are most likely to be positively influenced by certain collections benchmarks.

Further, according to a study conducted by The Institute of Customer Service, businesses that have a proactive approach to debt collection are more likely to recover their debts. The study found that businesses that actively chased late payments and contacted customers before their bills were due had a recovery rate of 69%, compared to a recovery rate of just 28% for businesses that took a reactive approach and only chased debts once they were overdue.

While common collections metrics and KPIs such as Right Party Contacts (RPC) and Profit per Account (PPA) are still useful for assessing volume and results, they don't give banks a better understanding of customer behaviours and responses. Total email delivery rates/bounce rates, email open rates, click-through rates, traffic by source or channel, landing page views and reaction times are just a few of the digital marketing KPIs that will help banks address the route of the problem with their collection processes.

Having access to this kind of detailed information will enable banks to deliver more specific optimisation, address any content issues and effectively automate some stages of the collection process.

Recovery rates can be drastically improved with a significant cost decrease when banks go digital with collections

On a more general basis, recovery rates can be drastically improved with a significant cost decrease when banks go digital with collections. Emails and text message payment reminders are more intertwined with the busy demands of everyday life and can be accessed on the go. Customers no longer have the time to take calls during work hours, and they often don't want to be bothered during their downtime. Letters asking them to go out of their way to make a payment, (such as those suggesting that they call them) will likely be greeted with frustration.

As discussed, using the analytics and behavioural insights presented by AI and ML tools and using digital forms of communication will allow banks to break down the barrier currently blocking them from improving the effectiveness and speed of collections.

Enhancing recovery strategies through digitalisation

How to make collections processes a critical part of a bank's overarching strategy

In previous sections, we've discussed the positive impact an innovative approach can have on the customer experience, churn rate and day-to-day operations, but what about a lender's central strategy?

Take the possibility of GAFA entering the banking industry as an example. Since the rise of digital banking and the decline of the branch, the relationships between banks and customers have dwindled. Financial institutions, in general, are under pressure to keep up with digital transformation, while maintaining an excellent customer experience. Google, Apple, Facebook and Amazon already have access to the data of billions of users around the world and are experts in communicating. For instance, when a customer orders something on Amazon, they'll receive several personalised emails and texts keeping them informed about the status of their delivery.

Financial institutions are under pressure to keep up with digital transformation while maintaining an excellent customer experience

In addition, GAFA is already leveraging cutting-edge technologies such as cloud computing, customer-facing artificial intelligence, and big data customer analytics. Given their existing capabilities, expanding their offerings to include lending and payment services would be a relatively smooth and seamless process.

Banks are compelled to recognise this threat and act to remain central in the lives of customers by creating an experience across both digital and physical environments. Banks that rely solely on letters and calls aren't taking the opportunity to address every touchpoint in the customer journey. One day a customer takes out a loan and is regarded as a valuable customer, and the next, they're in arrears and are being harassed to settle their account. They are also not leveraging that critical data pool in order to improve the origination of new loans and drive growth or a higher customer lifetime value.

For banks, addressing this issue and implementing it into their wider strategy is about taking note of GAFA's ability to effectively communicate and then integrate that data into every decision it's making.

As briefly outlined earlier, collections must be treated as a form of communication and not the imposition of terms. It's a matter of using all the digital touchpoints on offer and handling the situation well. Customers who enter a bank's collections cycle should remain valued and loyal customers.

Many forward-thinking telecoms, utilities, and finance companies today will send emails to their customers a week before a monthly direct debit leaves their account. This way, customers have the opportunity to check whether they have sufficient funds and take action if required. Adopting this approach prevents future payment issues and is a welcome reminder put in place to improve the customer experience.

There's no reason why banks and alternative lenders can't adopt a similar approach when it comes to reminding customers about loan payments, credit card payments and unarranged overdraft charges. Creating additional touchpoints to include customers who aren't in collections will create added value and serve as an opportunity to improve the customer experience, helping to safeguard at-risk borrowers earlier in the lending journey.

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While having access to the latest AI, ML, and digital automation technology is essential, it is equally crucial for banks to adopt the right mindset. Banks need to go beyond the basic objective of maximising cashflow and instead focus on establishing genuine financial relationships with customers. This approach is key to fostering loyalty, enhancing recovery efforts, and ultimately achieving higher overall returns.

By integrating this philosophy into their comprehensive strategy and leveraging the insights offered by the latest collections innovations, both banks and alternative lenders can thrive in the long run. It is imperative for them to embrace this mindset and capitalise on the knowledge provided by cutting-edge advancements, thereby paving the way for sustained success.

Navigating the future: smarter approaches to collections

Unlocking the fruits of technological advancements for early adopters

The future of collections holds immense potential, empowering forward-thinking banks and other lenders to elevate the customer journey. Through digital channels like email, SMS, and apps, banks can connect with their customers seamlessly, while the integration of AI and ML equips them with valuable insights for making data-driven decisions. Access to such information enables strategic thinkers to align with the bank's overarching goals, while operational teams gain a deeper understanding of customers, enabling personalised contact at optimal times and adaptable approaches tailored to their specific needs.

Likewise, banks can leverage digital channels to deliver personalised communications, incorporate additional touchpoints, and proactively send payment reminders. However, these actions mark only the initial stages of the transformative journey where banks can achieve impactful results by emphasising a truly evolved process that drives effective resolution.

Through AI-powered technology, financial institutions have the potential to enhance their existing scoring systems and make smarter customer risk assessments

Amazon effectively employs behavioural targeting, predictive modelling, and personalisation by utilising Alexa to identify customer keywords and deliver tailored advertisements. Similarly, banks can leverage dynamic content and behavioural economics to proactively send reminders, contact requests, and predictive payment plans, effectively preventing the need for collections. Taking a digital-first approach and harnessing open banking, Buy Now Pay Later (BNPL) providers leverage transaction data to build customer profiles, gaining actionable insights. This approach strengthens risk management, improves forecasting, and establishes a cohesive digital infrastructure

By operationalising available data, banks also have the potential to enhance their existing scoring system and make smarter risk assessments of customers. Further, improved scoring can also help achieve better segmentation by measuring value-at-risk and other metrics, and using these values as the foundation for different treatments. Combining established methodologies with operational data empowers banks to make informed decisions, shaping the desired loan book composition.

Using digital marketing metrics like email open rates, landing page views, email click-through rates, landing page conversions and response times allows banks to identify and react dynamically to the situation. This rapid reaction time is critical when deciding how to develop or adapt the strategy.

Essentials digital marketing KPIs to use in collections

Total email delivery rates

The percentage of emails that have been delivered.

Email bounce rate

The percentage of emails that haven't been delivered.

Email open rates

This shows the percentage of emails that have been opened by a customer.

Email click-through rates

The percentage or number of customers who have clicked a link or a call-to-action button in an email.

Traffic by source or channel

Where customers have come from – e.g. they've arrived on a payment landing page via email, SMS or a link included on a letter (direct visitors).

Landing page views

How many customers visited the payment landing page.

Landing page conversion

How many customers made a payment on the payment landing page.

Response time

How long it takes a customer to view an email or to make a payment.

Using these metrics for accurate scoring enables banks to price Non-Performing Loans (NPLs) with greater precision, enhancing their ability to identify accounts that are unrecoverable and should be sold. This leads to improved efficiency in managing these metrics for accurate scoring.

The global rise in smartphone users is set to continue influencing the way banks communicate with their customers. customers. As it stands, There are 4.32 billion active mobile users and 4.66 billion active web users. This will undoubtedly lead to legacy software making way for mobile-optimised payment landing pages, automated communications and rapid payment solutions.

Conclusion

In today's technology-driven world, abundant options exist, but the impact of GAFA on retail banks remains speculative despite their utilisation of cloud-based technology and advanced automation. Meanwhile, the banking industry must adopt smarter approaches to collections, recognising the critical value of operational data that, once fully integrated, can yield powerful results.

Similar to the gradual adoption of blockchain technology, banks show scepticism towards implementing new collections processes due to regulatory concerns. However, innovative debt management solutions do not carry the same uncertainties as volatile cryptocurrencies like Bitcoin. Established digital channels such as email and SMS present convenient avenues for customer engagement, enabling collections processes to align with sales and marketing techniques.

Advancements in artificial intelligence empower lenders to glean crucial behavioural traits and identify potential trends. In the realm of collections, this empowers banks to master the tone of their messages and deliver them at the optimal time through the most suitable channels.

> Banks that adopt future processes by harnessing AI, ML and digital automation now, have the potential to drive the overall business strategy

Modern digital marketing KPIs can provide banks with additional analytics on customer behaviour and recognise potential risks before they occur. For example, if a customer doesn't open up multiple emails, this could suggest that they're choosing to ignore and/or are experiencing financial hardship. As a result, banks can develop more personalised solutions to include nudges via further touchpoints.

Over the years, the collections process has gained a negative reputation due to its aggressive approach in pursuing outstanding payments. Banks, in particular, have been guilty of damaging customer relationships by repeatedly calling at inconvenient hours, subjecting them to long call queues, and relying on easily misplaced last-minute letters. Within a matter of weeks, customers can transition from feeling valued to feeling criminalised. The truth of the matter is that borrowers do not suddenly become problematic customers overnight. In many cases, it is the banks themselves who have neglected their customers' needs and failed to establish a comprehensive journey involving multiple touchpoints before resorting to the collections cycle.

Customers have a deep-rooted need to attain agency and control, which banks need to understand and appreciate. Collections must be treated as a form of communication and not the imposition of terms. It's a case of using the behavioural insights and analytics presented by AI and leveraging the effectiveness of digital channels to handle the situation effectively. Customers who are a part of the collections cycle should be converted into loyal customers for a lifetime depending on how they are treated, driving increases in customer lifetime value.

Looking ahead, the evolution of technology in collections is inevitable. AI will undoubtedly contribute to a more comprehensive experience, allowing for the establishment of boundaries and compliance with legal requirements, as well as the pursuit of optimisation goals. The ongoing development of behavioural targeting will continue, making predictive modelling and automated personalised communications a tangible reality. It's simply a matter of when, rather than if.

Banks that proactively adopt AI, machine learning (ML), and digital automation now have the potential to drive their overall business strategy. It begins with the ability to gain deeper insights into their customers and construct complete journeys that foster long-term connections for many years to come. By doing so, they will directly benefit from an improved Return on Experience (RoX) in their core business.

Take your debt management processes to the next level

If you're ready to adopt a future-proof collections approach, we invite you to book a demo today and learn why receeve is the best choice for your organisation. The demo will give you a chance to see how our platform can help you leverage customer data and behaviour, automate processes, maximise recoveries and minimise risk across every stage of the credit management lifecycle.

Book a demo today