McKinsey & Company

Risk Practice

The customer mandate to digitize collections strategies

Customers told us that more calling won’t improve lenders’ contact and recovery rates. Here’s what they said does work.

by Matt Higginson, Frédéric Jacques, and Glen Kushta

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Research into the customer experience of credit delinquency has helped clarify the path lenders need to take to achieve more effective collections. Essentially, customers told us that their contact preferences and responses are guided by personal considerations that bear little relationship to the risk categories and contact protocols worked out by lenders. Most customers prefer to be contacted and act through digital channels, while a smaller segment remains more responsive to traditional contact methods. From these findings, we have concluded that issuers need to better understand their customers' diverse preferences and then design a sensitive multichannel contact strategy to address them. The strategy requires coordinated capabilities—in technology and infrastructure; in advanced analytics, machine learning, and automation; and in a well-orchestrated deployment. The object is to deliver tailored messages through the right channels in the right sequence to the right customers. The cost of implementing a true multichannel strategy will amount to a small fraction of the return to issuers, in more efficient and effective recoveries and happier customers.

A no-regrets response to downward pressures

As economists and business analysts debate the time of arrival of the next economic downturn, lenders are weighing the implications of a possible contraction. Losses across several important asset classes have already begun to rise, for several reasons. In addition to economic factors, the trend has been fueled by lenders' actions, changing customer preferences, and stronger consumer regulation. During the global economy's long boom period, lenders experienced low losses and consequently tended to underinvest in collections. At the same time, customer contact preferences shifted decidedly to digital channels and away from the traditional methods lenders use for addressing delinquency. Meanwhile, regulators have placed limits on the scope and intensity of collections activities.

While the economic cycle and the regulatory environment are beyond lenders' control, they can reduce losses stemming from the poor success rate of customer contact. Our experience strongly suggests that lenders need to shift their own methods to match customer preferences—which are clearly for digital channels. In addition to improving outcomes, such a direction change in customer contact would also avoid regulatory repercussions. In the United States, for example, the Consumer Financial Protection Bureau is now proposing a limit of seven calls per customer per week—only a recommendation at this point, but one that would have profound implications for the collections and recovery industry.

Switching to digital-first contact will involve a significant change in collections strategy and operations, taking 12 to 18 months, so we are recommending that institutions get started as soon as possible. Particularly important is improving operational effectiveness of existing resources. Doing so will keep lenders ahead of any approaching down cycle in the macroeconomy. When that does arrive, losses will rapidly accelerate.

What the research revealed

In late 2018, we conducted a survey in North America of customers who were recently delinquent on a credit card in order to understand their experience of collections. The respondents were broadly representative of delinquent card customers in the market and roughly proportional to the relative sizes of the delinquent card population of 12 major issuers. We asked them about their lenders' contact approaches during delinquency, how they responded by channel, their preferred channels for engagement, and the outcomes of each contact attempt in various stages of delinquency.

Our goal was to uncover and explore the effects of mismatches between the contact strategies used by issuers and those preferred by their customers. Our ingoing hypothesis was that the customers' preferred channels were the most effective in debt repayment. The data we received strongly confirmed this.

Customer experience reveals misalignment of contact strategies

The responses of 1,000 delinquent customers enabled us to construct representative profiles of the delinquent population for each issuer, including customer risk profiles, days delinquent, and contact strategies used. Clear differences emerged in contact strategies from issuer to issuer in terms of the range of channels employed, the intensity of channel usage, and the sequencing of contact attempts according to risk profiles.

We discovered that most issuers still use traditional contact strategies based on customer balance, risk profile, and days delinquent. Some are beginning to integrate contact preferences and behavioral segmentation into their models. Yet lenders using digital channels such as email and text in early delinquency largely abandon them after 30 days, switching to traditional channels such as phone calls and letters.

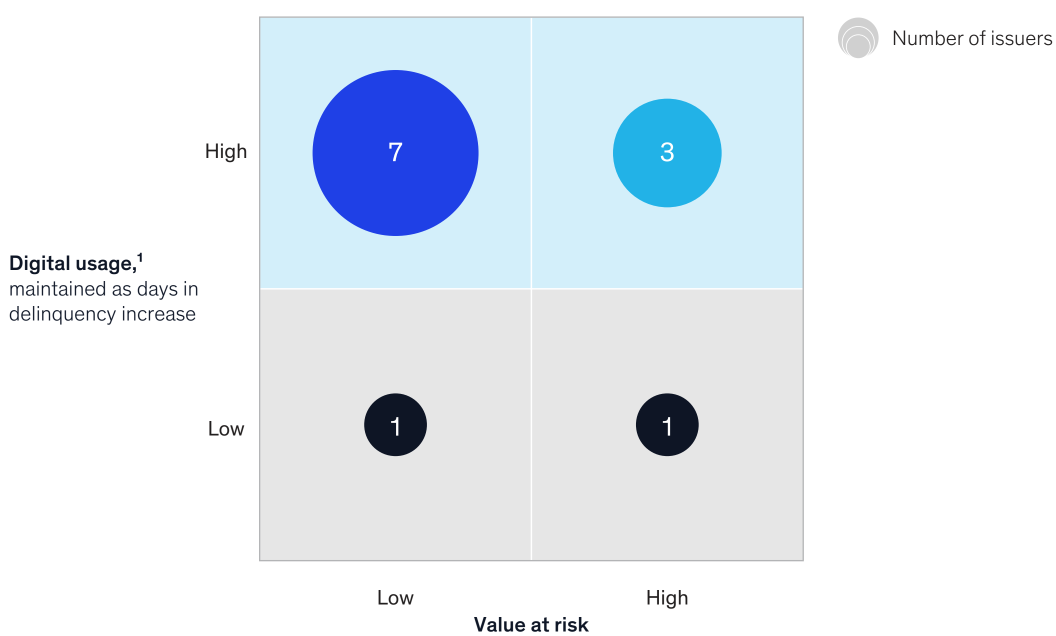
Using survey and issuer data, we plotted the collections landscape. The 12 issuers fell into four quadrants according to two main criteria: the value at risk in each portfolio and the usage of digital channels for contacting delinquent customers. Digital usage was measured according to issuer persistence in contacting customers through the stages of delinquency (Exhibit 1). This was because customers revealed that most issuers use digital channels in the beginning of delinquency but are more likely to revert to traditional channels later on.

The key takeaway from the early part of our research was that customer preferences for digital channels

Exhibit 1

Issuer and customer data revealed collections profiles for 12 credit-card issuers in terms of value at risk and contact strategies.

Issuers by digital usage and value at risk, disguised survey results



Note: Digital channels include email, text, mobile-app pop-up, online-banking pop-up, and phone push notification; digital share of contacts for last channel excludes respondents who were less than 30 days in delinquency. Value at risk for each customer is calculated as balance times probability of default (mapped from FICO score).

[1] Sum of digital share of contacts for first and last contact.

Source: S&P Capital IQ; McKinsey analysis remained pronounced through delinquency and were not aligned to or affected by issuer-assigned risk profiles.

From the customer viewpoint, therefore, issuers lag behind their own digital inclinations. For example, while higher-balance customers are more likely to engage digital channels such as mobile and online banking, most issuers are contacting only low-risk customers in this way. A handful of issuers—market leaders all—have begun implementing true multichannel-contact strategies across the full customer journey. The other issuers still have to capture this opportunity.

Customers express their engagement preferences

Though issuers remain wedded to traditional channels, using them even more heavily in later delinquency, their customers expressed a general preference for digital contact, primarily by email, followed by text message, irrespective of the prevailing stage of delinquency. The digital preference is most pronounced among customers with a low delinquent balance.

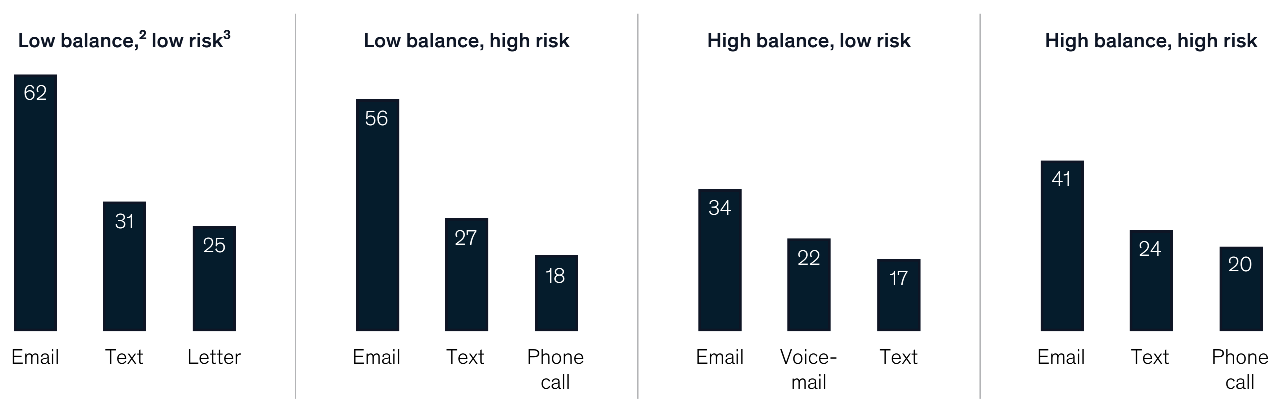
One responding segment did express a preference for traditional contact, however, though not for phone calls. Lower-risk customers—those with better credit scores—preferred impersonal messages in traditional channels, such as letters and voicemails, on which they are able to take action in their own time. Looking more closely at these traditional or "analog" customers, we found that they are commonly older, 44 years and above, have never used their account digitally or through an app, and ordinarily pay their balance in full. On the other hand, our survey's "digital" respondents were more commonly between the ages of 25 and 44, have recently used their account online or through an app, and more commonly revolve their balance, usually of $5,000 or less.

Exhibit 2 shows that credit-card customers most prefer email as a contact channel; this preference is most pronounced among customers with lower balances (less than $1,000). Unlike the high-risk groups, low-risk respondents prefer to engage through email and text rather than talking with a bank representative on the phone. For banks, the pattern of preferences clearly creates the

Exhibit 2

Credit-card customers mostly prefer to be contacted by email and 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.

potential for identifying a segment of customers for a self-service channel.

Matching channels and preferences

Customers in delinquency are sensitive to the contact method chosen by their bank. A deeper, nuanced segmentation of at-risk customers is needed.[1] In our survey, the majority of customers in the sample, whatever their financial position, expressed the preference for engaging with issuers through digital channels. When contacted digitally, they are more likely to make a payment or to pay in full, and this likelihood increases for customers with accounts that are more than 30 days past due (30+ DPD). Most indicated that they are less motivated to take action when contacted through traditional channels, though a minority still prefer to be contacted in this way (by phone or letter). This distinct traditional population usually pays in full.

Despite customer inclinations, banks are not using the channels that lead to the best collections outcomes.[2] The survey revealed that the majority of issuer-initiated contacts with delinquent customers are made through traditional channels (66 percent), with the following breakdown: 32 percent by phone, 16 percent by letter, and 15 percent by voicemail. Digital channels are used less often (35 percent), led by email (17 percent), and trailed by text (7 percent) and mobile push (6 percent). However, these channels resulted in much higher response rates, with customers taking action (making a payment) 73 percent of the time (Exhibit 3).

High success rates from neglected channels

The action rates—a partial or full payment—achieved by traditional channels were reported as 48 percent for phone, 50 percent each for voicemail and letter, and a whopping 91 percent for the ATM pop-up, the least-used traditional channel. Digital channels, on the other hand, have a much higher success rate overall: while only 58 percent of respondents made a partial or full payment when contacted by email, the success rates for both online banking and mobile-app pop-up were 92 percent; it was 88 percent for mobile push, and 77 percent for text.

Issuer contact through digital channels more often achieved full as opposed to partial payment. Here the success rate for traditional channels was around 12 percent overall for phone, voicemail, and letter.

[1] Ignacio Crespo and Arvind Govindarajan, “The analytics-enabled collections model,” *McKinsey on Risk,* April 2018, McKinsey.com.
[2] Matt Higginson, Frédéric Jacques, Marta Matecsa, and Davide Tesini, “Going digital in collections to improve resilience against credit losses,” *McKinsey on Risk,* April 2019, McKinsey.com.

Exhibit 3

The overall customer preferences for contact through email, text messaging, online banking, and mobile retain strength in late delinquency.

66%	73%
of issuer-initiated contact in late delinquency (30+ days) is made through traditional channels—despite lower response rates	of customers in late delinquency took action (made a payment) when contacted through digital channels

Source: McKinsey Survey of Credit-Card Customers at North American Financial Institutions, 2018

The rates for full payment from digital channels varied but were uniformly higher: 19 percent for email, 46 percent for online banking, 44 percent for mobile push, 20 percent for mobile app, and 19 percent for text.

Sensitivity by segment

The survey respondents revealed that issuer sensitivity to the preferences of the two (survey-driven) customer segments—digital and traditional—substantially improves payment outcomes (Exhibit 4). For example, digital customers were 12 percent more likely to make a payment when contacted through their preferred channels; they also paid in full more often when contacted in this way. With traditional customers, issuers had 17 percent better results with phone and letter contact.

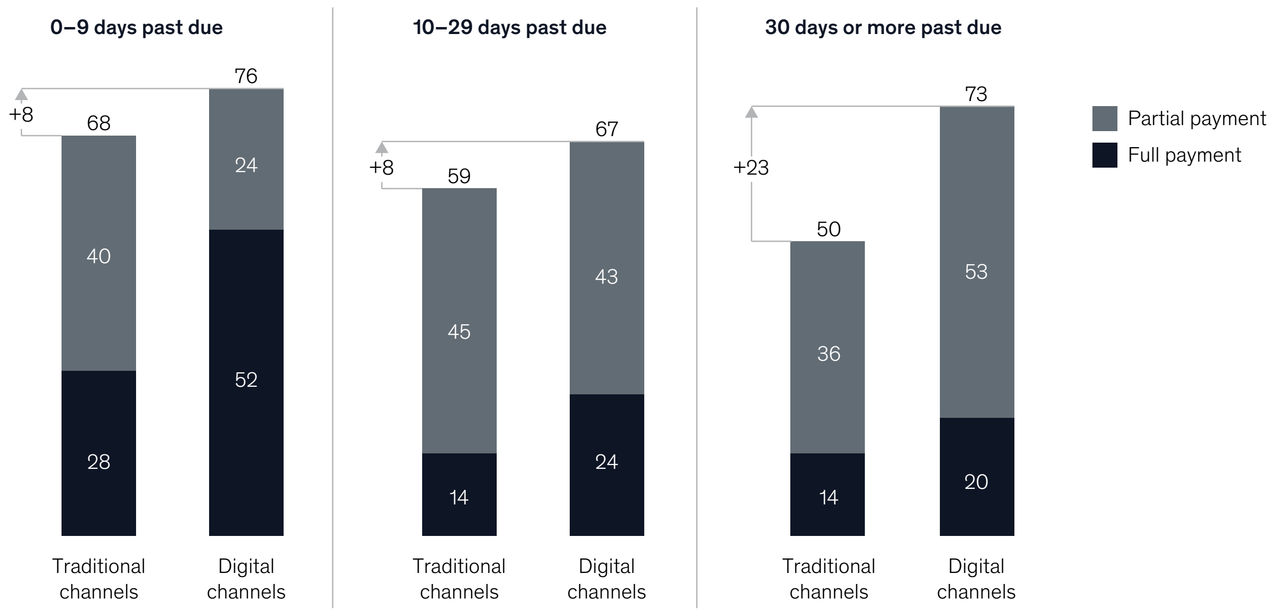
In terms of days past due (DPD), the effectiveness of contacting digital-first customers through their preferred channels improves most significantly in the 30+ DPD category (by 23 percent). Contact effectiveness declines almost as dramatically in this category when digital customers are contacted through traditional channels (–18 percent). While the overall payment rate remains similar for these customers, digital contacts result in more partial payments as customers become more delinquent.

Issuers assume traditional channels will be more effective at this point, but our survey indicates that the approach is not optimal for resolving customer delinquency. The survey suggested that the digital-to-traditional channel shift after early delinquency will likely yield 12 percent *fewer* payments from the great majority of customers

Exhibit 4

Contacting customers through preferred digital channels improves effectiveness most significantly in the 30-plus days past-due segment.

Payments made on last contact, %



(90 percent) who prefer digital contact. This supermajority are also more likely to make only partial payments when contacted traditionally.

The differences noted in our survey were the result of only crude segmentation of customers according to simple markers of contact preference. Without exception, issuers hold many more pieces of data about their customers than could be harvested in our survey, suggesting even greater improvement in collections effectiveness by following this proposed approach.

An effective multichannel contact strategy

To capture the collections opportunities indicated in customer responses to our survey, issuers need an effective multichannel contact strategy. Such a strategy does not take a one-size-fits-all approach to contacting delinquent customers, but it does recognize the superior effectiveness of and preference for digital channels overall. Most issuers, however, are still reliant on an approach centered around traditional contact methods.

The strategy depends on three kinds of capabilities and actions. First, the *technology and infrastructure* must be in place to support the development of the needed digital channels and self-service functionality. Second, capabilities in *data analytics, artificial intelligence, and automation* enable the identification and segmentation of customer types and preferences. Finally, the *contact strategy* must be deployed, addressing the segments appropriately, through the correct channels, with the right messages, in the proper sequence by segment.

Action steps
The action steps needed in the three areas are as follows.

1. Technology and infrastructure

— *Build digital channels.* Issuers need to expand digital assets to enable more email, text, mobile app, and online banking. Efforts to maximize customer qualification rates for digital contact channels are also highly recommended, including opt-in or -out, skip, and app access.

— *Invest in self-service capabilities.* Online banking and virtual collections agents could increase payments and reduce costs for call centers, while improving customer satisfaction. Most customers prefer to engage through an impersonal channel: if alerted by email and text, they can then take action by themselves.

2. Data analytics, AI, and automation

— *Create profiles and contact sequencing.* Data analytics and artificial intelligence (AI) can help banks build customer profiles, including preferences, balance history, and days past due. Based on these attributes, extended digital approaches can be crafted, including sequence of contact (such as text, email), aided by automated processes.

To capture the collections opportunities indicated in customer responses to our survey, issuers need an effective multichannel contact strategy.

— *Maintain sensitivity by profile.* A smaller group with traditional contact preferences will be less inclined to pay when contacted digitally; these should be prioritized early in delinquency with consistent phone and letter contacts. They might also pay in full voluntarily.

— *Apply machine learning.* Machine-learning algorithms for customer preferences can aid in shaping the most appropriate communications.

3. Designing and deploying the multichannel strategy

— *Design a truly integrated multichannel contact strategy.* This is done through improved sequencing and coordination across channels. A methodical approach should be applied to support the selection and matching of the right customer with the right channel, the right time, and the right offer. Future iterations should accommodate subsequent test and response learnings, preferably in near real time.

— *Tailor messaging.* The content, tone, and style of digital communications should be carefully crafted, in recognition that digital-first customers might be avoiding embarrassment or confrontation and need nuanced outreach (such as a softer tone).

Through our research, customers conveyed a clear message to issuers: to protect against credit losses, contact strategies should be shifted to match customer preferences. The path to a better customer outcome mainly involves expanding the use of digital channels for most customers, while preserving traditional channels to address a smaller but important segment. As market leaders already understand, an effective multichannel approach is a must, since the better collections departments get to know their customers, the more nuanced—and effective—the channel strategies they apply can be. The business case for doing this is compelling: the cost of going digital in collections will be a small fraction of the payoff in efficiency, effectiveness, and an improved customer experience that the strategy creates.

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