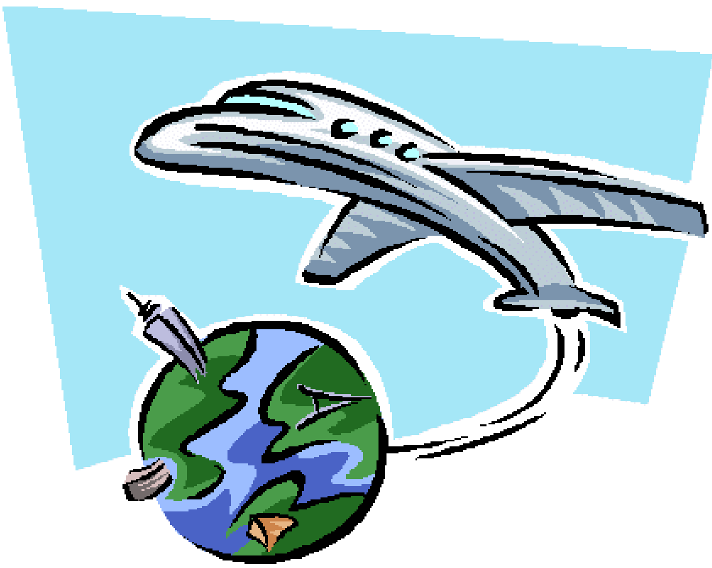
Making intelligent credit decisions based on client's ability to pay on time, devising rewards and penalties



Current payment effectiveness
Credit consumption patterns
Credit limit analysis
Actionable insights

Authors

Parvathy Sarath | Rajesh Kumar

March, 2013

01 N, 1st floor IIT Madras Research Park, Kanagam road, Chennai – 600113
Tel/Fax +91 44 66469877 |Email: info@aaumanalytics.com | Web www.aaumanalytics.com

Overview

The airline industry in India can be best described as one of the fast growing and the most turbulent industry. Large and growing middle class population, favorable demographics, rapid economic growth, higher disposable incomes, rising aspirations of the middle class, and overall low penetration levels promises huge growth potential from this sector. With increase in air travel, travel related service industry which provides ticket booking services on online or offline mode, forex services, corporate travel management are also booming.

However rising fuel costs, hostile cost environment, continued regulatory uncertainty and rupee depreciation, provides major challenges for the aviation sector to overcome. These challenges make operation conditions very difficult for travel related service companies. Corporate air travel is a very significant arena of business for travel related service companies. Most of the travel agencies have tie ups with corporate where they cater to all kinds of corporate travel and related services needs.

Some airlines comply to a semi regulated body known as known as International Air Transport Association (IATA) whose key functions is to administer worldwide the Billing and Settlement Plan which is designed to facilitate the flow of data and funds between travel agencies and airlines. It is mandatory for all travel agencies to settle the payments of BSP affiliated air carriers within a stipulated time period whether they receive funds from the customer or not. Most of the time airline travel agencies, especially those engaged in corporate travel experience a tough time in getting the customers to conform to the BSP system. As a result they are forced to fund the BSP carriers even if the customers do not make settlements. These are some of the hitches faced by travel agencies in corporate travel.

Our client, the largest integrated travel and service related company in India approached AAUM to understand the current payment effectiveness of their customers in corporate travel, credit consumption patterns of their customers and sector/class wise travel offerings to customers. In this case study, we have demonstrated how our analytics added value to the client organization. The approach adopted can be customized to other travel agencies.

Business need

Our client wanted to understand the settlement patterns of their customers and qualify customers on the basis of their effective payment pattern using data analytics. The current credit limit setting and revisions of the customers was also a major area of concern to the client. They also wanted to analyze the credit consumption pattern of the customers and revise the credit limit values for each customer accordingly.

Need validation

- Our client differentiates its corporate customers under three levels – group, company and sub company.

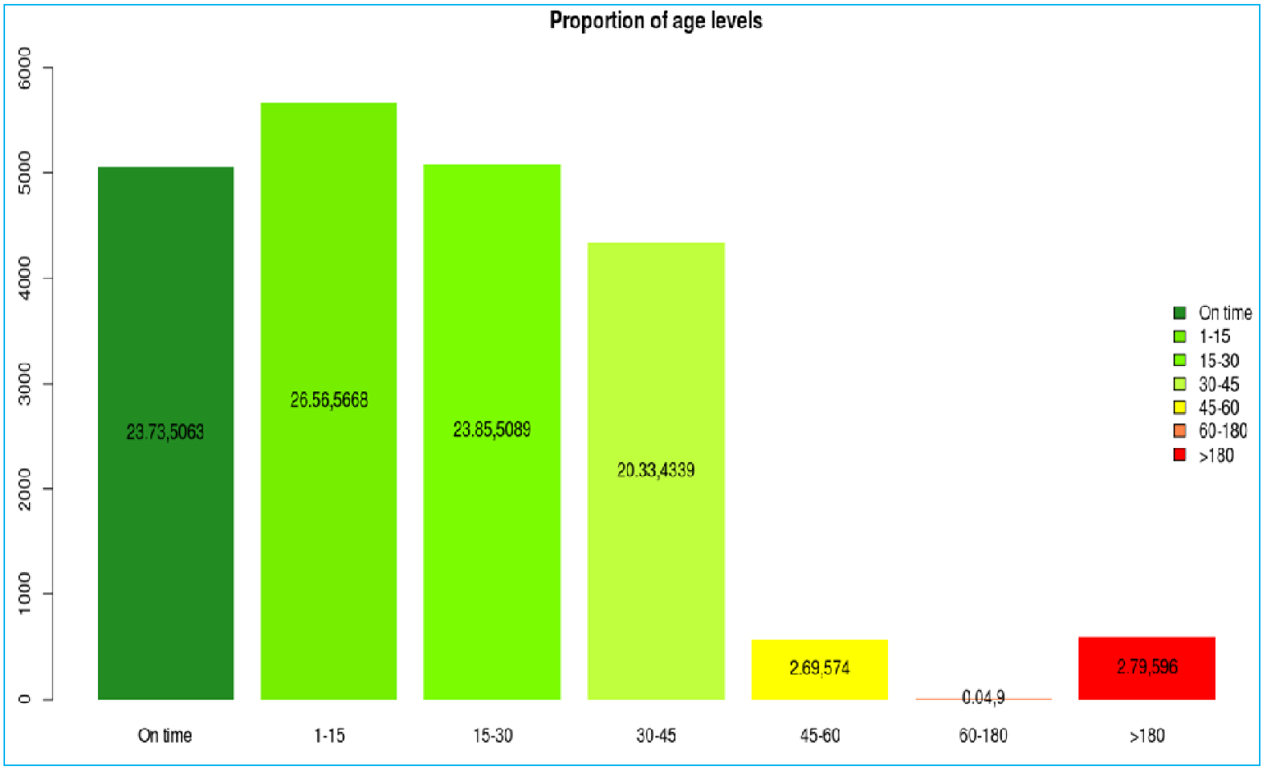
- Travel agencies are compelled to comply to the norms of BSP carriers. As per our analysis on an average each sub company takes around 45 days to settle travel invoices. Thus the client is plagued with the problem to arranging funds to comply to the norms of BSP carriers until they retrieve the funds from the customer. IATA has even proposed a change in their system to remit the ticket sale proceeds to airlines every week, in place of the current fortnightly span. This will worsen the situation of travel agents. Under these circumstances it is very necessary for our client to understand and evaluate the payment cycle of each customer.

- Our client sets Permanent Credit Limit to its customers at the group level and Temporary Credit Limit to its customers at company and sub company level. TCL provides a cushioning effect for companies to continue availing travel related services from the agency even if they have not made payments. Any extra amount of credit other than the PCL value given to the customer is considered as breach by the client. Around 38% of the clients customers breach more than once a year and the client is beset with the problem of tracking it effectively.

Solution

Measuring payment effectiveness

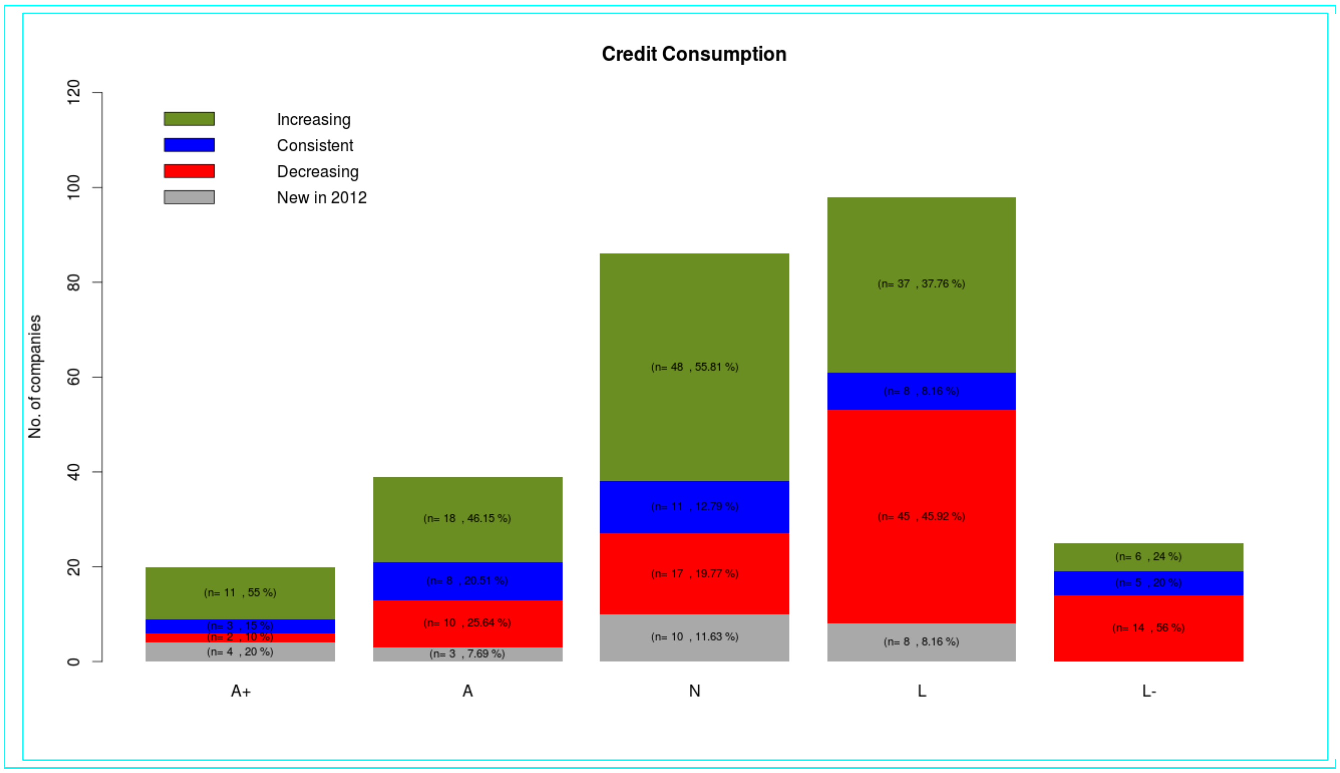
Our consultants came up with a payment tracking mechanism at the transaction level to evaluate and understand the effectiveness of the company's settlement cycle. This metric ties every invoice to its settlement date and qualifies companies on the basis of their average settlement period.



The above graph displays the payment pattern of BSP transactions at transaction level. Our analysts computed an age metric to qualify the settlement pattern of invoices and bucketed sub companies on basis of these metrics as 'On time',' 1-15', '15-30', '30-45' and so on. Companies coming under the level 'On time' imply that they conform to BSP standards and pay on time to the agents. 23.73 % of the invoices come under this level. However a discouraging 26% of the invoices come in the level 30-45 implying that these companies delay their payments by more than 30 days from the BSP date. This is a case of high concern to the client. Companies with a higher proportion of such delayed invoices pose a threat to the client as the client has to arrange for funds for them. These metrics help the client identify and qualify those companies on the basis of their payment pattern effectively and allow them to make preventive/corrective actions based on these.

Understanding credit consumption patterns

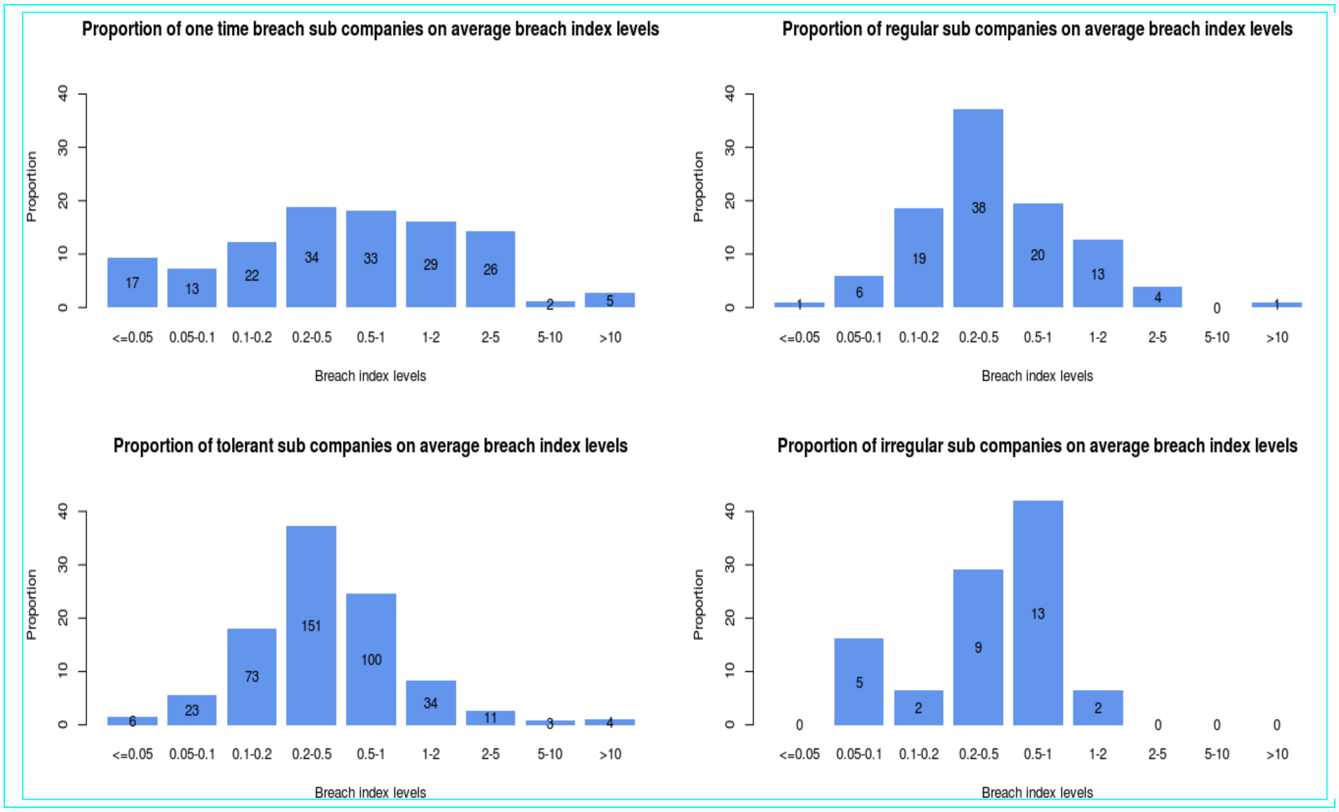
Understanding the customer's credit consumption level and allocating credit in tune with it is very vital to the clients business. This understanding of the customer's demand side is very essential to make sound and effective credit limit decisions. This analysis demonstrates how the companies are categorized on the basis of their degree of credit consumption.



Here we have categorized the companies into five different types based on the degree of their credit consumption as "A+" (Aggressive +), "A" (Aggressive), "N" (Normal), "L" (Laggard) and "L-" (Laggard -). "A+" signifies a very high level of credit consumption and "L-" very low consumption. The ranking is based on the individual assessment of credit consumption every year for three consecutive years. Further the companies are also bucketed on basis of their credit consumption trends over the years as increasing, decreasing and consistent (with respect to the previous year). Companies in the increasing and consistent trend in the A+ bucket can be targeted with higher credit limit. The client can base their credit decisions based on the credit consumption patterns of the customers.

Regularity on breaching

It is essential for the client to validate and measure the frequency of breaches among companies. Regularity metrics that we have devised qualify how regularly the companies breach on their amount.



The above figure shows the regularity of the sub companies on their breach index levels. Breach index here shows the magnitude of the breach. High breach index serves as a qualifier for bad credit decisions. Companies here are further categorized as very irregular, regular, tolerant, irregular and very irregular based on their breaching nature. Companies in the regular category with high breach index (to the tune of 1 or more than 1, top right quadrant) is a case of alarm for the client. This metric helps the client to understand and plan out the credit decisions of their customers efficiently.

Actionable insights

This case study demonstrates how effectively the payment pattern of each company is tracked at transaction level. The client can impose a stricter credit policy for customers who delay their payments regularly. Each company is then scored based on its credit consumption pattern. This gives insights on the demand side of the customer for the client to base its credit decisions on. Regularity metric on breach index qualifies the defaulting behavior of companies. It shows the regularity and quantum of the breaching behavior of companies. The companies coming under the regularly breaching category with higher breach index requires immediate revisions in their credit policy. This case study highlights how companies can be identified and scored effectively on their payment and defaulting behavior. It equips the management to arrive at better credit decisions.

Benefits

Data analytics is the next big and most happening thing around us. If companies do not use the vast information available to them to their own advantage, they are not using their resources efficiently. Using data analytics the client was able to devise a methodology to effectively qualify the payment cycle, ageing metrics, understand credit consumption patterns and optimize the travel offerings to customers. The client was also able to identify and revise the PCL assignments for those companies who were consistently over using their credit.

Software

AAUM's proprietary analytics platform

About Aaum

Aaum Research and Analytics founded by IIT Madras alumnus brings in extensive global business experience working with Fortune 100 companies in North America and Asia Pacific. Incubated at IIT Madras Incubator ecosystem with a focus on researching and devising the sophisticated analytical techniques to solve the pressing business needs of corporations ranging from travel & logistics, finance, insurance, HR, Health Care, Entertainment, FMCGs, retail, Telecom.

Contact us

01 N, 1st floor IIT Madras Research Park, Kanagam road, Chennai – 600113

Tel: +91 44 66469877 **Fax:** +91 44 66469877

Email: info@aaumanalytics.com **Skype:** b.rajeshkumar

Twitter: AaumAnalytics **Web:** www.aaumanalytics.com

Facebook: http://www.facebook.com/AaumAnalytics

LinkedIn: http://www.linkedin.com/company/aaum-research-and-analytics-iit-madras